NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 2**

NCUA 8006 (M3500) DATE: January 2005

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 2 to the National Credit Union Administration Rules and Regulations (Revised April 2004).

1. **PURPOSE.** To update the April 2004 edition of the National Credit Union Administration Rules and Regulations in the following manner:

   a. **Part 701—Organization and Operation of Federal Credit Unions.**

   § 701.14—Change in Official or Senior Executive Officer in Credit Unions that are Newly Chartered or are in Troubled Condition. Removed paragraphs (c), (d), and (e). Also added new paragraphs (c) and (d), and redesignated paragraph (f) as paragraph (e).

   § 701.36—Federal Credit Union Ownership of Fixed Assets. Revised the entire section.

   b. **Part 717—Fair Credit Reporting.** New part added.

   c. **Part 723—Member Business Loans.**

   § 723.3—What are the requirements for construction and development lending? Revised the introductory sentence.

   § 723.4—What other regulations apply to member business lending? Revised the entire section.

   § 723.7—What are the collateral and security requirements? Revised paragraph (a) introductory text.

   § 723.10—What waivers are available? Revised paragraph (h).

   d. **Part 742—regulatory Flexibility Program.**

   § 742.4—From what NCUA regulations will I be exempt? Revised paragraph (a).

   e. **Part 747—Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations.**

   Subpart K—Inflation Adjustment of Civil Money Penalties.

   § 747.1001—Adjustment of civil money penalties by the rate of inflation. Revised paragraph (a).

f. **Part 748—Security Program, Report of Crime and Catastrophic Act and Bank Secrecy Act Compliance.**

Appendix A to Part 748—Guidelines for Safeguarding Member Information Added sentence to the end of paragraph I; added sentence to the end of paragraph I.A.; redesignated paragraphs I.B.2. a. through d. as I.B.2.c. through f.; added new paragraphcs 1.B.2.a. and b.; Removed the word "and" after the word "information" in paragraph II.B. Added a phrase after the word "member" at the end of the sentence. Added new paragraphs III.G.3. and III.G.4.

2. This revision also corrects typing and printing errors.
3. **INSTRUCTIONS:**
   a. Your April 2004 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
701–3 thru 701–4	701–3 thru 701–4
701–21 thru 701–24	701–21 thru 701–24
712–1 thru 712–2	712–1 thru 712–2
	717–1 thru 717–2
723–1 thru 723–6	723–1 thru 723–7
742–1 thru 742–2	742–1 thru 742–2
747–33 thru 747–34	747–33 thru 747–34
748–1 thru 748–5	748–1 thru 748–5
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4. **PREAMBLES.** Enclosed with Change 2 are Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

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Part 701—Organization and Operations of Federal Credit Unions

Part 702—Prompt Corrective Action*

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(ii) has been granted assistance as outlined under Sections 208 or 216 of the Federal Credit Union Act.

(c) *Procedures for Notice of Proposed Change in Official or Senior Executive Officer*—(1) *Prior Notice Requirement.* An insured credit union must give NCUA written notice at least 30 days before the effective date of any addition or replacement of a member of the board of directors or committee member or the employment or change in responsibilities of any individual to a position of senior executive officer if:

(i) The credit union has been chartered for less than two years; or

(ii) The credit union meets the definition of troubled condition in paragraph (b)(3) or (4) of this section.

(2) *Waiver of Prior Notice*—(i) *Waiver requests.* Parties may petition the appropriate Regional Director for a waiver of the prior notice required under this section. Waiver may be granted if it is found that delay could harm the credit union or the public interest.

(ii) *Automatic waiver.* In the case of the election of a new member of the board of directors or credit committee member at a meeting of the members of a federally insured credit union, the prior 30-day notice is automatically waived and the individual may immediately begin serving, provided that a complete notice is filed with the appropriate Regional Director within 48 hours of the election. If NCUA disapproves a director or credit committee member, the board of directors of the credit union may appoint its own alternate, to serve until the next annual meeting, contingent on NCUA approval.

(iii) *Effect on disapproval authority.* A waiver does not affect the authority of NCUA to issue a Notice of Disapproval within 30 days of the waiver or within 30 days of any subsequent required notice.

(3) *Filing procedures*—(i) *Where to file.* Notices will be filed with the appropriate Regional Director or, in the case of a corporate credit union, with the Director of the Office of Corporate Credit Unions. All references to Regional Director will, for corporate credit unions, mean the Director of Office of Corporate Credit Unions. State-chartered federally insured credit unions will also file a copy of the notice with their state supervisor.

(ii) *Contents.* The notice must contain information about the competence, experience, character, or integrity of the individual on whose behalf the notice is submitted. The Regional Director or his or her designee may require additional information. The information submitted must include the identity, personal history, business background, and experience of the individual, including material business activities and affiliations during the past five years, and a description of any material pending legal or administrative proceedings in which the individual is a party and any criminal indictment or conviction of the individual by a state or federal court. Each individual on whose behalf the notice is filed must attest to the validity of the information filed. At the option of the individual, the information may be forwarded to the Regional Director by the individual; however, in such cases, the credit union must file a notice to that effect.

(iii) *Processing.* Within ten calendar days after receiving the notice, the Regional Director will inform the credit union either that the notice is complete or that additional, specified information is needed and must be submitted within 30 calendar days. If the initial notice is complete, the Regional Director will issue a written decision of approval or disapproval to the individual and the credit union within 30 calendar days of receipt of the notice. If the initial notice is not complete, the Regional Director will issue a written decision within 30 calendar days of receipt of the original notice plus the amount of time the credit union takes to provide the requested additional information. If the additional information is not submitted within 30 calendar days of the Regional Director's request, the Regional Director may either disapprove the proposed individual or review the notice based on the information provided. If the credit union and the individual have submitted all requested information and the Regional Director has not issued a written decision within the applicable time period, the individual is approved.

(d) *Commencement of Service.* A proposed director, committee member, or senior executive officer may begin service after the end of the 30-day period or any other additional period as provided under paragraph (c)(3)(iii) of this section, unless the NCUA disapproves the notice before the end of the period.

(e) *Notice of Disapproval.* NCUA may disapprove the individual's serving as a director, committee member or senior executive officer if it finds that the competence, experience, character, or integrity of the individual with respect to whom a notice under this section is submitted indicates

that it would not be in the best interests of the members of the credit union or of the public to permit the individual to be employed by, or associated with, the credit union. The Notice of Disapproval will advise the parties of their rights of appeal pursuant to 12 CFR Part 747 subpart J of NCUA's Regulations.

§§ 701.15–701.18 [Reserved]

§ 701.19 Benefits for Employees of Federal Credit Unions.

(a) *General authority.* A federal credit union may provide employee benefits, including retirement benefits, to its employees and officers who are compensated in conformance with the Act and the bylaws, individually or collectively with other credit unions. The kind and amount of these benefits must be reasonable given the federal credit union's size, financial condition, and the duties of the employees.

(b) *Plan trustees and custodians.* Where a federal credit union is the benefit plan trustee or custodian, the plan must be authorized and maintained in accordance with the provisions of part 724 of this chapter. Where the benefit plan trustee or custodian is a party other than a federal credit union, the benefit plan must be maintained in accordance with applicable laws governing employee benefit plans, including any applicable rules and regulations issued by the Secretary of Labor, the Secretary of the Treasury, or any other federal or state authority exercising jurisdiction over the plan.

(c) *Investment authority.* A federal credit union investing to fund an employee benefit plan obligation is not subject to the investment limitations of the Act and part 703 or, as applicable, part 704, of this chapter and may purchase an investment that would otherwise be impermissible if the investment is directly related to the federal credit union's obligation or potential obligation under the employee benefit plan and the federal credit union holds the investment only for as long as it has an actual or potential obligation under the employee benefit plan.

(d) *Defined benefit plans.* Under paragraph (c) of this section, a federal credit union may invest to fund a defined benefit plan if the investment meets the conditions provided in that paragraph. If a federal credit union invests to fund a defined benefit plan that is not subject to the fiduciary responsibility provisions of part 4 of the Employee Retirement Income Security Act of 1974, it should diversify its investment portfolio to minimize the risk of large losses unless it is clearly prudent not to do so under the circumstances.

(e) *Liability insurance.* No federal credit union may occupy the position of a fiduciary, as defined in the Employee Retirement Income Security Act of 1974 and the rules and regulations issued by the Secretary of Labor, unless it has obtained appropriate liability insurance as described and permitted by Section 410(b) of the Employee Retirement Income Security Act of 1974.

(f) *Definitions.* For this section, defined benefit plan has the same meaning as in 29 U.S.C. 1002(35) and employee benefit plan has the same meaning as in 29 U.S.C. 1002(3).

§ 701.20 Suretyship and guaranty.

(a) *Scope.* This section authorizes a federal credit union to enter into a suretyship or guaranty agreement as an incidental powers activity. This section does not apply to the guaranty of public deposits or the assumption of liability for member accounts.

(b) *Definitions.* A *suretyship* binds a federal credit union with its principal to pay or perform an obligation to a third person. Under a *guaranty* agreement, a federal credit union agrees to satisfy the obligation of the principal only if the principal fails to pay or perform. The *principal* is the person primarily liable, for whose performance of his obligation the surety or guarantor has become bound.

(c) *Requirements.* The suretyship or guaranty agreement must be for the benefit of a principal that is a member and is subject to the following conditions:

(1) The federal credit union limits its obligations under the agreement to a fixed dollar amount and a specified duration;

(2) The federal credit union's performance under the agreement creates an authorized loan that complies with the applicable lending regulations, including the limitations on loans to one member or associated members or officials for purposes of §§ 701.21(c)(5), (d); 723.2 and 723.8; and

(3) The federal credit union obtains a segregated deposit from the member that is sufficient in amount to cover the federal credit union's total potential liability.

(d) *Collateral.* A segregated deposit under this section includes collateral:

(1) In which the federal credit union has perfected its security interest (for example, if the collateral is a printed security, the federal

§ 701.36 FCU Ownership of Fixed Assets.

(a) *Investment in Fixed Assets.* (1) No Federal credit union with $1,000,000 or more in assets may invest in any fixed assets if the investment would cause the aggregate of all such investments to exceed five percent of the credit union's shares and retained earnings.

(2) The NCUA may waive the prohibition in paragraph (a)(1) of this section.

(i) A Federal credit union desiring a waiver must submit a written request to the NCUA regional office having jurisdiction over the geographical area in which the credit union's main office is located. The request must describe in detail the contemplated investment and the need for the investment. The request must also indicate the approximate aggregate amount of fixed assets, as a percentage of shares and retained earnings, that the credit union would hold after the investment.

(ii) The regional director will inform the requesting credit union, in writing, of the date the request was received and of any additional documentation that the regional director might require in support of the waiver request.

(iii) The regional director will approve or disapprove the waiver request in writing within 45 days after receipt of the request and all necessary supporting documentation. If the regional director approves the waiver, the regional director will establish an alternative limit on aggregate investments in fixed assets, either as a dollar limit or as a percentage of the credit union's shares and retained earnings. Unless otherwise specified by the regional director, the credit union may make future acquisition of fixed assets only if the aggregate all of such future investments in fixed assets does not exceed an additional one percent of the shares and retained earnings of the credit union over the amount approved by the regional director.

(iv) If the regional director does not notify the credit union of the action taken on its request within 45 calendar days of the receipt of the waiver request or the receipt of additional requested supporting information, whichever occurs later, the credit union may proceed with its proposed investment in fixed assets. The investment, and any future investments in fixed assets, must not cause the credit union to exceed the aggregate investment limit described in its waiver request.

(b) *Premises Not Currently Used To Transact Credit Union Business.* (1) When a Federal credit union acquires premises for future expansion and does not fully occupy the space within one year, the credit union must have a board resolution in place by the end of that year with definitive plans for full occupation. Premises are fully occupied when the credit union, or a combination of the credit union, CUSOs, or vendors, use the entire space on a full-time basis. CUSOs and vendors must be using the space primarily to support the credit union or to serve the credit union's members. The credit union must make any plans for full occupation available to an NCUA examiner upon request.

(2) When a Federal credit union acquires premises for future expansion, the credit union must partially occupy the premises within a reasonable period, not to exceed three years. Premises are partially occupied when the credit union is using some part of the space on a full-time basis. The NCUA may waive this partial occupation requirement in writing upon written request. The request must be made within 30 months after the property is acquired.

(3) A Federal credit union must make diligent efforts to dispose of abandoned premises and any other real property not intended for use in the conduct of credit union business. The credit union must seek fair market value for the property, and record its efforts to dispose of abandoned premises. After premises have been abandoned for four years, the credit union must publicly advertise the property for sale. Unless otherwise approved in writing by the NCUA, the credit union must complete the sale within five years of abandonment.

(c) *Prohibited Transactions.* (1) Without the prior written approval of the NCUA, no federal credit union may invest in premises through an acquisition or a lease of one year or longer from any of the following:

(i) A director, member of the credit committee or supervisory committee, or senior management employee of the federal credit union, or immediate family member of any such individual.

(ii) A corporation in which any director, member of the credit committee or supervisory committee, official, or senior management employee, or immediate family members of any such individual, is an officer or director, or has a stock interest of 10 percent or more.

(iii) A partnership, limited liability company, or other entity in which any director, member of the credit committee or supervisory committee, or senior management employee, or immediate family members of any such individual, is a general partner, or a limited partner or entity member with an interest of 10 percent or more.

(2) The prohibition contained in paragraph (c)(1) of this section also applies to a lease from any other employee if the employee is directly involved in investments in fixed assets unless the board of directors determines that the employee's involvement does not present a conflict of interest.

(3) All transactions with business associates or family members not specifically prohibited by this paragraph (c) must be conducted at arm's length and in the interest of the credit union.

(d) *Regulatory Flexibility Program.* Federal credit unions that qualify for the Regulatory Flexibility Program provided for in part 742 of this chapter are exempt from the five percent limitation described in paragraph (a) of this section. For Federal credit unions eligible for the Regulatory Flexibility Program that subsequently lose eligibility:

(1) Section 742.8 of this chapter provides that NCUA may require the credit union to divest any existing fixed assets for substantive safety and soundness reasons; and

(2) The credit union may not make any new investments in fixed assets if, after the investment, the credit union's total investments in fixed assets would exceed the five percent limitation described in paragraph (a) of this section. The regional director may waive this prohibition to allow for new investments.

(e) *Definitions*—As used in this section:

(1) *Abandoned premises* means real property previously used to transact credit union business but no longer used for that purpose and real property originally acquired for future expansion for which the credit union no longer contemplates such use.

(2) *Fixed assets* means premises, furniture, fixtures and equipment.

(3) *Furniture, fixtures, and equipment* means all office furnishings, office machines, computer hardware and software, automated terminals, and heating and cooling equipment.

(4) *Investments in fixed assets* means:

(i) Any investment in improved or unimproved real property which is being used or is intended to be used as premises;

(ii) Any leasehold improvement on premises;

(iii) The aggregate of all capital and operating lease payments on fixed assets, without discounting commitments for future payments to present value; and

(iv) Any investment in furniture, fixtures and equipment.

(5) *Immediate family* member means a spouse or other family members living in the same household.

(6) *Premises* means any office, branch office, suboffice, service center, parking lot, other facility, or real estate where the credit union transacts or will transact business.

(7) *Senior management employee* means the credit union's chief executive officer (typically this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (*e.g.*, Assistant President, Vice President or Assistant Treasurer/Manager) and the chief financial officer (Comptroller).

(8) *Shares* means regular shares, share drafts, share certificates, other savings.

(9) *Retained earnings* means undivided earnings, regular reserve, reserve for contingencies, supplemental reserves, reserve for losses, and other appropriations from undivided earnings as designated by management or the Administration.

§ 701.37 Treasury Tax and Loan Depositaries; Depositaries and Financial Agents of the Government.

(a) *Definitions.*

(1) "Treasury Tax and Loan ("TT&L") Remittance Account" means a nondividend-paying account, the balance of which is subject to the right of immediate withdrawal, established for receipt of payments of Federal taxes and certain United States obligations under United States Treasury Department regulations.

(2) "TT&L Note Account" means an account subject to the right of immediate call, evidencing funds held by depositaries electing the note option under United States Treasury Department regulations.

(3) "Treasury General Account" means an account, established under United States Treasury Department regulations, in which a zero balance may be maintained and from which

the entire balance may be withdrawn by the depositor immediately under all circumstances except closure of the credit union;

(4) "U.S. Treasury Time Deposit-Open Account" means a nondividend-bearing account, established under United States Treasury Department regulations, which generally may not be withdrawn until the expiration of 14 days after the date of the United States Treasury Department's written notice of intent to withdraw.

(b) Subject to regulation of the United States Treasury Department, a Federal credit union may serve as a Treasury tax and loan depositary, a depositary of Federal taxes, a depositary of public money, and a financial agent of the United States Government. In serving in these capacities, a Federal credit union may maintain the accounts defined in subsection (a), pledge collateral, and perform the services described under United States Treasury Department regulations for institutions acting in these capacities.

(c) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and a U.S. Treasury Time Deposit-Open Account shall be considered deposits of public funds. Funds held in a TT&L Remittance Account and a TT&L Note Account shall be added together and insured up to a maximum of $100,000 in the aggregate. Funds held in a Treasury General Account and a U.S. Treasury Time Deposit-Open Account shall be added together and insured up to a maximum of $100,000 in the aggregate.

(d) Funds held in a TT&L Remittance Account, a TT&L Note Account, a Treasury General Account, and U.S. Treasury Time Deposit-Open Account are not subject to the 60-day notice requirement of Article III, section 5(a) of the Federal Credit Union Bylaws.

§ 701.38 Borrowed Funds From Natural Persons.

(a) Federal credit unions may borrow from a natural person, PROVIDED:

(1) The borrowing is evidenced by a signed promissory note which sets forth the terms and conditions regarding maturity, prepayment, interest rate, method of computation, and method of payment;

(2) The promissory note and any advertisement for such funds contains conspicuous language indicating that:

(i) the note represents money borrowed by the credit union;

(ii) the note does not represent shares and, therefore, is not insured by the National Credit Union Share Insurance Fund.

§ 701.39 Statutory lien.

(a) *Definitions.* Within this section, each of the following terms has the meaning prescribed below:

(1) *Except as otherwise provided by law* or *except as otherwise provided by federal law* is a qualifying phrase referring to a federal and/or state law, as the case may be, which supersedes a requirement of this section. It is the responsibility of the credit union to ascertain whether such statutory or case law exists and is applicable;

(2) *Impress* means to attach to a member's account and is the act which makes the lien enforceable against that account;

(3) *Member* means any member who is primarily, secondarily or otherwise responsible for an outstanding financial obligation to the credit union, including without limitation an obligor, maker, co-maker, guarantor, co-signer, endorser, surety or accommodation party;

(4) *Notice* means written notice to a member disclosing, in plain language, that the credit union has the right to impress and enforce a statutory lien against the member's shares and dividends in the event of failure to satisfy a financial obligation, and may enforce the right without further notice to the member. Such notice must be given at the time, or at any time before, the member incurs the financial obligation;

(5) *Statutory lien* means the right granted by section 107(11) of the Federal Credit Union Act, 12 U.S.C. 1757(11), to a federal credit union to establish a right in or claim to a member's shares and dividends equal to the amount of that member's outstanding financial obligation to the credit union, as that amount varies from time to time.

(b) *Superior claim.* Except as otherwise provided by law, a statutory lien gives the federal credit union priority over other creditors when claims are asserted against a member's account(s).

(c) *Impressing a statutory lien.* Except as otherwise provided by federal law, a credit union can impress a statutory lien on a member's account(s)—

(1) *Account records.* By giving notice thereof in the member's account agreement(s) or other account opening documentation; or

(2) *Loan documents.* In the case of a loan, by giving notice thereof in a loan document signed or otherwise acknowledged by the member(s); or

(3) *By-Law or policy.* Through a duly adopted credit union by-law or policy of the board of directors, of which the member is given notice.

(d) *Enforcing a statutory lien.* (1) *Application of funds.* Except as otherwise provided by federal law, a federal credit union may enforce its statutory lien against a member's account(s) by debiting funds in the account and applying them to the extent of any of the member's outstanding financial obligations to the credit union.

(2) *Default required.* A federal credit union may enforce its statutory lien against a member's account(s) only when the member fails to satisfy an outstanding financial obligation due and payable to the credit union.

(3) *Neither judgment nor set-off required.* A federal credit union need not obtain a court judgment on the member's debt, nor exercise the equitable right of set-off, prior to enforcing its statutory lien against the member's account.

Part 712

Credit Union Service Organizations (CUSOs)

§ 712.1 What does this part cover?

This part establishes when a Federal credit union (FCU) can invest in and make loans to CUSOs. CUSOs are subject to review by NCUA. This part does not apply to corporate credit unions that have CUSOs subject to § 704.11 of this title. This part does not apply to state-chartered credit unions or the subsidiaries of state-chartered credit unions that do not have FCU investments or loans.

§ 712.2 How much can an FCU invest in or loan to CUSOs, and what parties may participate?

(a) *Investments.* An FCU's total investments in CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report.

(b) *Loans.* An FCU's total loans to CUSOs must not exceed, in the aggregate, 1% of its paid-in and unimpaired capital and surplus as of its last calendar year-end financial report. Loan authority is independent and separate from the 1% investment authority of subsection (a) of this section.

(c) *Parties.* An FCU may invest in or loan to a CUSO by itself, or with non-credit union parties.

(d) *Measurement for calculating regulatory limitation.* For purposes of paragraphs (a) and (b) of this section:

(1) *Paid-in and unimpaired capital and surplus* means shares plus post-closing, undivided earnings (this does not include regular reserves or special reserves required by law, regulation or special agreement between the credit union and its regulator or share insurer); and

(2) Total investments in and total loans to CUSOs will be measured consistent with GAAP.

(e) *Divestiture.* If the limitations in paragraph (a) of this section are reached or exceeded because of the profitability of the CUSO and the related GAAP valuation of the investment under the equity method, without an additional cash outlay by the FCU, divestiture is not required. An FCU may continue to invest up to 1% without regard to the increase in the GAAP valuation resulting from a CUSO's profitability.

§ 712.3 What are the characteristics of and what requirements apply to CUSOs?

(a) *Structure.* An FCU can invest in a CUSO only if the CUSO is structured as a corporation, limited liability company, or limited partnership. An FCU may only participate in a limited partnership as a limited partner. For purposes of this part, "corporation" means a legally incorporated corporation as established and maintained under relevant federal or state law. For purposes of this part, "limited partnership" means a legally established limited partnership as established and maintained under relevant state law. For purposes of this part, "limited liability company" means a legally established limited liability company as established and maintained under relevant state law, provided that the FCU obtains written legal advice that the limited liability company is a recognized legal entity under the applicable laws of the state of formation and that the limited liability company is established in a manner that will limit potential exposure of the FCU to no more than the amount of funds invested in, or loaned to, the CUSO.

(b) *Customer base.* An FCU can invest in or loan to a CUSO only if the CUSO primarily serves credit unions, its membership, or the membership of credit unions contracting with the CUSO.

(c) *Federal credit union accounting for financial reporting purposes.* An FCU must account for its investments in or loans to a CUSO in conformity with "generally accepted accounting principles" (GAAP).

(d) *CUSO accounting; audits and financial statements; NCUA access to information.* An FCU must obtain written agreements from a CUSO, prior to investing in or lending to the CUSO, that the CUSO will:

(1) Account for all its transactions in accordance with GAAP;

(2) Prepare quarterly financial statements and obtain an annual opinion audit, by a licensed Certified Public Accountant, on its financial statements in accordance with "generally accepted auditing standards" (GAAS); and

(3) Provide NCUA and its representatives with complete access to any books and records of the CUSO and the ability to review CUSO internal controls, as deemed necessary by NCUA in carrying out its responsibilities under the Act.

(e) *Other laws.* A CUSO must comply with applicable Federal, state and local laws.

§ 712.4 What must an FCU and a CUSO do to maintain separate corporate identities?

(a) *Corporate separateness.* An FCU and a CUSO must be operated in a manner that demonstrates to the public the separate corporate existence of the FCU and the CUSO. Good business practices dictate that each must operate so that:

(1) Its respective business transactions, accounts, and records are not intermingled;

(2) Each observes the formalities of its separate corporate procedures;

(3) Each is adequately financed as a separate unit in the light of normal obligations reasonably foreseeable in a business of its size and character;

(4) Each is held out to the public as a separate enterprise;

(5) The FCU does not dominate the CUSO to the extent that the CUSO is treated as a department of the FCU; and

(6) Unless the FCU has guaranteed a loan obtained by the CUSO, all borrowings by the CUSO indicate that the FCU is not liable.

(b) *Legal opinion.* Prior to an FCU investing in a CUSO, the FCU must obtain written legal advice as to whether the CUSO is established in a manner that will limit potential exposure of the FCU to no more than the loss of funds invested in, or lent to, the CUSO. In addition, if a CUSO in which an FCU has an investment plans to change its structure under § 712.3(a), an FCU must also obtain prior, written legal advice that the CUSO will remain established in a manner that will limit potential exposure of the FCU to no more than the loss of funds invested in, or loaned to, the CUSO. The legal advice must address factors that have led courts to "pierce the corporate veil" such as inadequate capitalization, lack of separate corporate identity, common boards of directors and employees, control of one entity over another, and lack of separate books and records. The legal advice may be provided by independent legal counsel of the investing FCU or the CUSO.

§ 712.5 What activities and services are preapproved for CUSOs?

NCUA may at any time, based upon supervisory, legal, or safety and soundness reasons, limit any CUSO activities or services, or refuse to permit any CUSO activities or services. Otherwise, an FCU may invest in, loan to, and/or contract with only those CUSOs that are sufficiently bonded or insured for their specific operations and engaged in the preapproved activities and services related to the routine daily operations of credit unions. The specific activities listed within each preapproved category are provided in this section as illustrations of activities permissible under the particular category, not as an exclusive or exhaustive list.

(a) *Checking and currency services:*

(1) Check cashing;

(2) Coin and currency services; and

(3) Money order, savings bonds, travelers checks, and purchase and sale of U.S. Mint commemorative coins services;

(b) *Clerical, professional and management services:*

(1) Accounting services;

(2) Courier services;

(3) Credit analysis;

(4) Facsimile transmissions and copying services;

(5) Internal audits for credit unions;

(6) Locator services;

(7) Management and personnel training and support;

(8) Marketing services;

(9) Research services; and

(10) Supervisory committee audits;

(c) *Business loan origination;*

(d) *Consumer mortgage loan origination;*

(e) *Electronic transaction services:*

(1) Automated teller machine (ATM) services;

(2) Credit card and debit card services;

(3) Data processing;

(4) Electronic fund transfer (EFT) services;

(5) Electronic income tax filing;

(6) Payment item processing;

(7) Wire transfer services; and

(8) Cyber financial services;

(f) *Financial counseling services:*

(1) Developing and administering Individual Retirement Accounts (IRA), Keogh, deferred compensation, and other personnel benefit plans;

Part 717

Fair Credit Reporting

Subpart A—General Provisions

§ 717.1–717.2 [Reserved]

§ 717.3 Definitions.

As used in this part, unless the context requires otherwise:

(a) [Reserved]
(b) [Reserved]
(c) [Reserved]
(d) [Reserved]
(e) *Consumer* means an individual.
(f) [Reserved]
(g) [Reserved]
(h) [Reserved]
(i) [Reserved]
(j) [Reserved]
(k) [Reserved]
(l) [Reserved]
(m) [Reserved]
(n) [Reserved]
(o) *You* means a Federal credit union.

Subpart I—Duties of Users of Consumer Reports Regarding Identity Theft

§ 717.80–717.82 [Reserved]

§ 717.83 Disposal of consumer information.

(a) *In general.* You must properly dispose of any consumer information that you maintain or otherwise possess in a manner consistent with the Guidelines for Safeguarding Member Information, in appendix A to part 748 of this chapter.

(b) *Examples.* Appropriate measures to properly dispose of consumer information include the following examples. These examples are illustrative only and are not exclusive or exhaustive methods for complying with this section.

(1) Burning, pulverizing, or shredding papers containing consumer information so that the information cannot practicably be read or reconstructed.

(2) Destroying or erasing electronic media containing consumer information so that the information cannot practicably be read or reconstructed.

(c) *Rule of construction.* This section does not:

(1) Require you to maintain or destroy any record pertaining to a consumer that is not imposed under any other law; or

(2) Alter or affect any requirement imposed under any other provision of law to maintain or destroy such a record.

(d) *Definitions.* As used in this section:

(1) *Consumer information* means any record about an individual, whether in paper, electronic, or other form, that is a consumer report or is derived from a consumer report and that is maintained or otherwise possessed by or on behalf of the credit union for a business purpose. Consumer information also means a compilation of such records. The term does not include any record that does not identify an individual.

(i) *Consumer information* includes:

(A) A consumer report that you obtain;

(B) Information from a consumer report that you obtain from your affiliate after the consumer has been given a notice and has elected not to opt out of that sharing;

(C) Information from a consumer report that you obtain about an individual who applies for but does not receive a loan, including any loan sought by an individual for a business purpose;

(D) Information from a consumer report that you obtain about an individual who guarantees a loan (including a loan to a business entity); or

(E) Information from a consumer report that you obtain about an employee or prospective employee.

(ii) *Consumer information* does not include:

(A) Aggregate information, such as the mean credit score, derived from a group of consumer reports; or

(B) Blind data, such as payment history on accounts that are not personally identifiable, you use for developing credit scoring models or for other purposes.

(2) *Consumer report* has the same meaning as set forth in the Fair Credit Reporting Act, 15 U.S.C. 1681a(d). The meaning of consumer report is broad and subject to various definitions, conditions and exceptions in the Fair Credit Reporting Act. It includes written or oral communications from a consumer reporting agency to a third party of information used or collected for use in establishing eligibility for credit or insurance used primarily for personal, family or household purposes, and eligibility for employment purposes. Examples include credit reports, bad check lists, and tenant screening reports.

Part 723

Member Business Loans

§ 723.1 What is a member business loan?

(a) *General rule.* A member business loan includes any loan, line of credit, or letter of credit (including any unfunded commitments) where the borrower uses the proceeds for the following purposes:

(1) Commercial;

(2) Corporate;

(3) Other business investment property or venture; or

(4) Agricultural.

(b) *Exceptions to the general rule.* The following are not member business loans:

(1) A loan fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;

(2) A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;

(3) Loan(s) to a member or an associated member which, when the net member business loan balances are added together, are equal to less than $50,000;

(4) A loan where a federal or state agency (or its political subdivision) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full; or

(5) A loan granted by a corporate credit union to another credit union.

(c) *Loans to credit unions and credit union service organizations.* This part does not apply to loans made by federal credit unions to credit unions and credit union service organizations. This part does not apply to loans made by a federally insured, state-chartered credit union to credit unions and credit union service organizations if the credit union's supervisory authority determines that state law grants authority to lend to these entities other than the general authority to grant loans to members.

(d) *Purchase of member loans and member loan participations.* Any interest a credit union obtains in a loan that was made by another lender to the credit union's member is a member business loan, for purposes of this rule and the risk weighting standards of part 702 of this chapter to the same extent as if made directly by the credit union to its member.

(e) *Purchases of nonmember loans and nonmember loan participations.* Any interest a credit union obtains in a nonmember loan, pursuant to § 701.22 or part 742 of this chapter or other authority, is treated the same as a member business loan for purposes of this rule and the risk weighting standards under part 702 of this chapter, except that the effect of such interest on a credit union's aggregate member business loan limit will be as set forth in § 723.16(b) of this part.

§ 723.2 What are the prohibited activities?

(a) *Who is ineligible to receive a member business loan?* You may not grant a member business loan to the following:

(1) Your chief executive officer (typically this individual holds the title of President or Treasurer/Manager);

(2) Any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager);

(3) Your chief financial officer (Comptroller); or

(4) Any associated member or immediate family member of anyone listed in paragraphs (a) (1) through (3) of this section.

(b) *Equity agreements/joint ventures.* You may not grant a member business loan if any additional income received by the credit union or senior management employees is tied to the profit or sale of the business or commercial endeavor for which the loan is made.

(c) *Loans to compensated directors.* A credit union may not grant a member business loan to a compensated director unless the board of directors approves granting the loan and the compensated director is recused from the decision making process.

§ 723.3 What are the requirements for construction and development lending?

Except as provided in § 723.4 or unless your Regional Director grants a waiver, loans granted for the construction or development of commercial or residential property are subject to the following additional requirements.

(a) The aggregate of the net member business loan balances for all construction and development loans must not exceed 15% of net worth. In determining the aggregate balances for purposes of this limitation, a credit union may exclude any loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and may also exclude a loan to finance the construction of one single-family residence per member-borrower or group of associated member-borrowers, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property.

(b) The borrower must have a minimum of 25% equity interest in the project being financed, the value of which is determined by the market value of the project at the time the loan is made, except that this requirement will not apply in the case of a loan made to finance the construction of a single-family residence if a prospective homeowner has contracted to purchase the property and in the case of one loan to a member-borrower or group of associated member-borrowers to finance the construction of a single-family residence, irrespective of the existence of a contractual commitment from a prospective homeowner to purchase the property. Instead, the collateral requirements of § 723.7 will apply; and

(c) The funds may be released only after on-site, written inspections by qualified personnel and according to a preapproved draw schedule and any other conditions as set forth in the loan documentation.

§ 723.4 What other regulations apply to member business lending?

(a) The provisions of § 701.21(a) through (g) and part 702 of this chapter apply to member business loans granted by credit unions to the extent they are consistent with this part. Except as required by part 741 of this chapter, federally insured State-chartered credit unions are not required to comply with the provisions of § 701.21(a) through (g) of this chapter.

(b) If a federal credit union makes a member business loan as part of a Small Business Administration guaranteed loan program with loan requirements that are less restrictive than those required by NCUA, then the federal credit union may follow the loan requirements of the relevant Small Business Administration guaranteed loan program to the extent they are consistent with this part. A federally insured State-chartered credit union that is subject to this part and makes a member business loan as part of a Small Business Administration guaranteed loan program with loan requirements that are less restrictive than those required by NCUA may follow the loan requirements of the relevant Small Business Administration guaranteed loan program to the extent they are consistent with this part if its state supervisory authority has determined that the credit union has authority to do so under State law.

(c) The collateral and security requirements of § 723.3 and § 723.7 do not apply to member business loans made as part of a Small Business Administration guaranteed loan program.

§ 723.5 How do you implement a member business loan program?

(a) *Generally.* The board of directors must adopt specific business loan policies and review them at least annually. The board must also use the services of an individual with at least two years direct experience with the type of lending the credit union will be engaging in. The experience must provide the credit union sufficient expertise given the complexity and risk exposure of the loans in which the credit union intends to engage. Credit unions do not have to hire staff to meet the requirements of this section but must ensure that the expertise is available. A credit union can meet the experience requirement through various approaches. For example, a credit union can use the services of a credit union service organization (CUSO), an employee of another credit union, an independent contractor, or other third parties. However, the actual decision to grant a loan must reside with the credit union.

(b) *Conflicts of Interest.* Any third party used by a credit union to meet the requirements of paragraph (a) of this section must be independent from the transaction and is prohibited from having a

participation in the loan or an interest in the collateral securing the loan that the third party is responsible for reviewing, with the following exceptions:

(1) The third party may provide a service to the credit union related to the transaction, such as loan servicing;

(2) The third party may provide the requisite experience to the credit union and purchase a loan or a participation interest in a loan originated by the credit union that the third party reviewed; or

(3) A credit union may use the services of a CUSO that otherwise meets the requirements of paragraph (a) of this section even though the CUSO is not independent from the transaction, provided the credit union has a controlling financial interest in the CUSO as determined under Generally Accepted Accounting Principles.

§ 723.6 What must your member business loan policy address?

At a minimum, your policy must address the following:

(a) The types of business loans you will make;

(b) Your trade area;

(c) The maximum amount of your assets, in relation to net worth, that you will invest in secured and unsecured business loans;

(d) The maximum amount of your assets, in relation to net worth, that you will invest in a given category or type of business loan;

(e) The maximum amount of your assets, in relation to net worth, that you will loan to any one member or group of associated members, subject to § 723.7(c)(2) and § 723.8;

(f) The qualifications and experience of personnel (minimum of 2 years) involved in making and administering business loans;

(g) A requirement to analyze and document the ability of the borrower to repay the loan consistent with appropriate underwriting and due diligence standards, which also addresses the need for periodic financial statements, credit reports, and other data when necessary to analyze future loans and lines of credit, such as, borrower's history and experience, balance sheet, cash flow analysis, income statements, tax data, environmental impact assessment, and comparison with industry averages, depending upon the loan purpose;

(h) The collateral requirements must include:

(1) Loan-to-value ratios;

(2) Determination of value;

(3) Determination of ownership;

(4) Steps to secure various types of collateral; and

(5) How often the credit union will reevaluate the value and marketability of collateral;

(i) The interest rates and maturities of business loans;

(j) General loan procedures which include:

(1) Loan monitoring;

(2) Servicing and follow-up; and

(3) Collection;

(k) Identification of those individuals prohibited from receiving member business loans.

§ 723.7 What are the collateral and security requirements?

(a) Except as provided in § 723.4 or unless your Regional Director grants a waiver, all member business loans, except those made under paragraphs (c), (d), and (e) of this section, must be secured by collateral as follows:

(1) The maximum loan-to-value ratio for all liens must not exceed 80% unless the value in excess of 80% is covered through private mortgage insurance or equivalent type of insurance, or insured, guaranteed, or subject to advance commitment to purchase by an agency of the federal government, an agency of a state or any of its political subdivisions, but in no case may the ratio exceed 95%;

(2) A borrower may not substitute any insurance, guarantee, or advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state for the collateral requirements of this paragraph.

(b) Principals, other than a not for profit organization as defined by the Internal Revenue Service Code (26 U.S.C. 501) or those where the Regional Director grants a waiver, must provide their personal liability and guarantee. Federal credit unions and federally insured state-chartered credit unions that meet RegFlex standards, as determined pursuant to Part 742 of this Chapter, are exempt from this requirement and may make their own determination whether to require the personal liability and guarantee of principals.

(c) You may make unsecured member business loans under the following conditions:

(1) You are well capitalized as defined by § 702.102(a)(1) of this chapter;

(2) The aggregate of the unsecured outstanding member business loans to any one member or group of associated members does not exceed the lesser of $100,000 or 2.5% of your net worth; and

(3) The aggregate of all unsecured outstanding member business loans does not exceed 10% of your net worth.

(d) You are exempt from the provisions of paragraphs (a), (b), and (c) of this section with respect to credit card line of credit programs offered to nonnatural person members that are limited to routine purposes normally made available under those programs.

(e) You may make vehicle loans under this part without complying with the loan-to-value ratios in this section, provided that the vehicle is a car, van, pick-up truck, or sports utility vehicle and not part of a fleet of vehicles.

§ 723.8 How much may one member or a group of associated members borrow?

Unless your Regional Director grants a waiver for a higher amount, the aggregate amount of net member business loan balances to any one member or group of associated members must not exceed the greater of:

(a) 15% of the credit union's net worth; or

(b) $100,000.

§ 723.9 Removed and Reserved.

§ 723.10 What waivers are available?

You may seek a waiver for a category of loans in any of the following areas:

(a) Appraisal requirements under § 722.3;

(b) Aggregate construction and development loans limits under § 723.3(a);

(c) Minimum borrower equity requirements for construction and development loans under § 723.3(b);

(d) Loan-to-value ratio requirements for business loans under § 723.7(a);

(e) Requirement for personal liability and guarantee under § 723.7(b);

(f) Maximum unsecured business loans to one member or group of associated members under § 723.7(c)(2);

(g) Maximum aggregate unsecured member business loan limit under § 723.7(c)(3); and

(h) Maximum aggregate net member business loan balance to any one member or group of associated members under § 723.8.

§ 723.11 How do you obtain a waiver?

To obtain a waiver, a federal credit union must submit a request to the Regional Director (a corporate federal credit union submits the waiver request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the request to the Regional Director (or if appropriate the Director of the Office of Corporate Credit Unions). A waiver is not effective until it is approved by the Regional Director (or in the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The waiver request must contain the following:

(a) A copy of your business lending policy;

(b) The higher limit sought (if applicable);

(c) An explanation of the need to raise the limit (if applicable);

(d) Documentation supporting your ability to manage this activity; and

(e) An analysis of the credit union's prior experience making member business loans, including as a minimum:

(1) The history of loan losses and loan delinquency;

(2) Volume and cyclical or seasonal patterns;

(3) Diversification;

(4) Concentrations of credit to one borrower or group of associated borrowers in excess of 15% of net worth;

(5) Underwriting standards and practices;

(6) Types of loans grouped by purpose and collateral; and

(7) The qualifications of personnel responsible for underwriting and administering member business loans.

§ 723.12 What will NCUA do with my waiver request?

Your Regional Director (or the Director of the Office of Corporate Credit Unions) will:

(a) Review the information you provided in your request;

(b) Evaluate the level of risk to your credit union;

(c) Consider your credit union's historical CAMEL composite and component ratings when evaluating your request; and

(d) Notify you whenever your waiver request is deemed complete. Notify you of the action taken within 45 calendar days of receiving a complete request from the federal credit union or the state supervisory authority. If you do not receive notification within 45 calendar days of the date the complete request was received by the regional office, the credit union may assume approval of the waiver request.

§ 723.13 What options are available if the NCUA Regional Director denies my waiver request or a portion of it?

You may appeal the Regional Director's (or the Director of the Office of Corporate Credit Unions) decision in writing to the NCUA Board. Your appeal must include all information requested in § 723.11 and why you disagree with your Regional Director's (or the Office of Corporate Credit Union Director's) decision.

§ 723.14 Removed and Reserved.

§ 723.15 Removed and Reserved.

§ 723.16 What is the aggregate member business loan limit for a credit union?

(a) *General.* The aggregate limit on a credit union's net member business loan balances is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Net worth is all of the credit union's retained earnings. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities. Loans that are exempt from the definition of member business loans are not counted for the purpose of the aggregate loan limit.

(b) *Effect of nonmember loans and nonmember participations.* If a credit union holds any nonmember loans or nonmember loan participation interests that would constitute a member business loan if made to a member, those loans will affect the credit union's aggregate limit on net member business loan balances as follows:

(1) The total of the credit union's net member business loan balances and the nonmember loan balances must not exceed the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets, unless the credit union has first received approval from the NCUA regional director.

(2) To request approval from the NCUA regional director, a credit union must submit an application that:

(i) Includes a current copy of the credit union's member business loan policies;

(ii) Confirms that the credit union is in compliance with all other aspects of this rule;

(iii) States the credit union's proposed limit on the total amount of nonmember loans and participation interests that the credit union may acquire if the application is granted; and

(iv) Attests that the acquisition of nonmember loans and participations is not being used, in conjunction with one or more other credit unions, to have the effect of trading member business loans that would otherwise exceed the aggregate limit.

(3) A federal credit union must submit its request for approval to the regional director (a corporate federal credit union submits its request to the Director of the Office of Corporate Credit Unions). A state chartered federally insured credit union must submit the request to its state supervisory authority. If the state supervisory authority approves the request, the state regulator will forward the application and its decision to the regional director (or if appropriate, the Director of the Office of Corporate Credit Unions). An approved application is not effective until it is approved by the regional director (or in the case of a corporate federal credit union the Director of the Office of Corporate Credit Unions). The regional director will issue a decision within 30 days of receipt of a federal credit union's completed application or within 30 days of receipt of a completed application and the state supervisory authority's approval for a state chartered federally insured credit union.

§ 723.17 Are there any exceptions to the aggregate loan limit?

There are three circumstances where a credit union qualifies for an exception from the aggregate

limit. Loans that are excepted from the definition of member business loans are not counted for the purpose of the exceptions. The three exceptions are:

(a) Credit unions that have a low-income designation or participate in the Community Development Financial Institutions program;

(b) Credit unions that were chartered for the purpose of making member business loans and can provide documentary evidence (such evidence includes but is not limited to the original charter, original bylaws, original business plan, original field of membership, board minutes and loan portfolio);

(c) Credit unions that have a history of primarily making member business loans, meaning that either member business loans comprise at least 25% of the credit union's outstanding loans (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements) or member business loans comprise the largest portion of the credit union's loan portfolio (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements). For example, if a credit union makes 23% member business loans, 22% first mortgage loans, 22% new automobile loans, 20% credit card loans, and 13% total other real estate loans, then the credit union meets this exception.

§ 723.18 How do I obtain an exception?

To obtain the exception, a federal credit union must submit documentation to the Regional Director, demonstrating that it meets the criteria of one of the exceptions. A state chartered federally insured credit union must submit documentation to its state supervisory authority. The state supervisory authority will forward its decision to NCUA. The exception does not expire unless revoked by the state supervisory authority for a state chartered federally insured credit union or the Regional Director for a federal credit union. If an exception request is denied for a federal credit union, it may be appealed to the NCUA Board within 60 days of the denial by the Regional Director. Until the NCUA Board acts on the appeal, the credit union can continue to make new member business loans.

§ 723.19 What are the recordkeeping requirements?

You must separately identify member business loans in your records and in the aggregate on your financial reports.

§ 723.20 How can a state supervisory authority develop and enforce a member business loan regulation?

(a) The NCUA Board may exempt federally insured state chartered credit unions in a given state from NCUA's member business loan rule if NCUA approves the state's rule for use for state chartered federally insured credit unions. In making this determination, the Board is guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business loan rule in this part. Specifically, the Board will focus its review on:

(1) The definition of a member business loan;

(2) Loan to one borrower limits;

(3) Written loan policies;

(4) Collateral and security requirements;

(5) Construction and development lending; and

(6) Loans to senior management.

(b) To receive NCUA's approval of a state's member business loan rule, the state supervisory authority must submit its rule to the NCUA regional office. After reviewing the rule, the region will forward the request to the NCUA Board for a final determination.

§ 723.21 Definitions.

For purposes of this part, the following definitions apply:

Associated member is any member with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower.

Construction or development loan is a financing arrangement for acquiring property or rights to property, including land or structures, with the intent to convert it to income-producing property

such as residential housing for rental or sale; commercial use; industrial use; or similar uses.

Immediate family member is a spouse or other family member living in the same household.

Loan-to-value ratio is the aggregate amount of all sums borrowed including outstanding balances plus any unfunded commitment or line of credit from all sources on an item of collateral divided by the market value of the collateral used to secure the loan.

Net member business loan balance means the outstanding loan balance plus any unfunded commitments, reduced by any portion of the loan that is secured by shares in the credit union, or by shares or deposits in other financial institutions, or by a lien on the member's primary residence, or insured or guaranteed by any agency of the federal government, a state or any political subdivision of such state, or subject to an advance commitment to purchase by any agency of the federal government, a state or any political subdivision of such state, or sold as a participation interest without recourse and qualifying for true sales accounting under generally accepted accounting principles.

Net worth is retained earnings as defined under Generally Accepted Accounting Principles. Retained earnings normally includes undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities.

Part 742

Regulatory Flexibility Program

§ 742.1 What is NCUA's Regulatory Flexibility Program?

NCUA's Regulatory Flexibility Program (RegFlex) exempts credit unions with a current net worth of nine percent (or if a credit union is subject to a risk-based net worth requirement under § 702.103 of this chapter, it must be 200 basis points over its risked based net worth level or nine percent, whichever is higher) and a CAMEL rating of 1 or 2, for two consecutive examinations, from all or part of identified NCUA regulations. The Regulatory Flexibility Program also grants eligible credit unions additional powers.

§ 742.2 How do I become eligible for the Regulatory Flexibility Program?

Eligibility is automatic as soon as the credit union meets the net worth and CAMEL criteria. If a credit union is a CAMEL 3 (or CAMEL 1 or 2 for less than two consecutive cycles) with a net worth in excess of 9 percent or if the credit union is a CAMEL 1 or 2 with a net worth under 9 percent (or if a credit union is subject to a risk-based net worth requirement under § 702.103 of this chapter, and it does not exceed 200 basis points over its risk based net worth level), it can apply to the regional director for a RegFlex designation, in whole or in part.

§ 742.3 Will NCUA notify me when I am eligible for the Regulatory Flexibility Program?

Yes. Once this rule is effective, NCUA will notify all RegFlex eligible credit unions. Subsequent notifications of eligibility will occur after an application for a RegFlex designation or as part of the examination process.

§ 742.4 From what NCUA regulations will I be exempt?

(a) RegFlex credit unions are exempt from the provisions of the following NCUA regulations without restrictions or limitations: § 701.25, § 701.32(b) and (c), § 701.36(a), § 703.5(b)(1)(ii) and (2), § 703.12(c), § 703.16(b), and § 723.7(b) of this chapter.

(b) RegFlex credit unions are exempt from the provisions of the following NCUA regulations with certain restrictions or limitations:

(1) Section 703.13(d)(3) of this chapter, provided the value of the investments that mature later than the borrowing repurchase transaction does not exceed 100 percent of the Federal credit union's net worth; and

(2) Section 703.16(d) of this chapter provided:

(i) The issuer of the security is domestic;

(ii) The security is rated in one of the two highest rating categories by at least one nationally-recognized statistical rating organization;

(iii) The security meets the definition of mortgage related security as defined in 15 U.S.C. 78c(a)(41) and the definition of commercial mortgage related security as defined in § 703.2 of this chapter;

(iv) The security's underlying pool of loans contains more than 50 loans with no one loan representing more than 10 percent of the pool; and

(v) The aggregate total of commercial mortgage related securities purchased by the Federal credit union does not exceed 50 percent of its net worth.

§ 742.5 What additional authority will I be granted?

Notwithstanding the general limitations in § 701.23 of this chapter, RegFlex credit unions are eligible to purchase any auto loan, credit card loan, member business loan, student loan or mortgage loan from any federally insured credit union as long as the loans are loans that the purchasing credit union is empowered to grant. RegFlex credit unions are authorized to keep these loans in their portfolio. If a RegFlex credit union is purchasing

the eligible obligations of a liquidating credit union, the loans purchased cannot exceed 5% of the unimpaired capital and surplus of the purchasing credit union.

§ 742.6 How can I lose my RegFlex eligibility?

Eligibility may be lost in two ways. First, the credit union no longer meets the RegFlex criteria set forth in § 742.1. When this event occurs, the credit union must cease using the additional authority granted by this rule. Second, the regional director for substantive and documented safety and soundness reasons may revoke a credit union's RegFlex authority in whole or in part. The regional director must give a credit union written notice stating the reasons for this action. The revocation is effective as soon as the regional director's determination has been received by the credit union.

§ 742.7 What is the appeal process?

A credit union has 60 days from the date of the regional director's determination to revoke a credit union's RegFlex authority (in whole or in part) to appeal the action to NCUA's Supervisory Review Committee. The regional director's determination will remain in effect unless the Supervisory Review Committee issues a different determination. If the credit union is dissatisfied with the decision of the Supervisory Review Committee, the credit union has 60 days from the issuance of this decision to appeal to the NCUA Board.

§ 742.8 If I lose my RegFlex authority, will my past actions be grandfathered?

Any action by the credit union under the RegFlex authority will be grandfathered. Any actions subsequent to losing the RegFlex authority must meet NCUA's regulatory requirements. This does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

her counsel in order to assist counsel in understanding technical issues. These latter circumstances should be rare, are left to the discretion of the officer conducting the investigation, and shall not in any event be allowed to serve as a ruse to coordinate testimony between witnesses, to oversee or supervise the testimony of any witness, or otherwise defeat the beneficial effects of the witness sequestration rule.

(d) The officer conducting the investigation may report to the NCUA Board any instances where any witness or counsel has been guilty of dilatory, obstructionist or contumacious conduct during the course of a formal investigative proceeding or any other instance of violations of these rules. The NCUA Board will thereupon take such further action as the circumstance may warrant including barring the offending person from further participation in the particular formal investigative proceeding or even from further practice before the Board.

Subpart J—Local Procedures and Standards Applicable to a Notice of Change in Senior Executive Officers, Directors or Committee Members Pursuant to Section 212 of the Act

§ 747.901 Scope.

The rules and procedures set forth in this Subpart shall apply to the notice filed by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, for the consent of the NCUA to add to or replace an individual on the board of directors or supervisory or credit committee, or to employ any individual as a senior executive officer or change the responsibilities of any individual to a position of senior executive officer where the credit union either has been chartered less than 2 years; or is in "troubled condition," as defined in § 701.14 of this Chapter. Subpart A of this Part shall not apply to any proceeding under this Subpart.

§ 747.902 Grounds for Disapproval of Notice.

The NCUA Board or its designee may issue a notice of disapproval with respect to a notice submitted by a credit union pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter, where the competence, experience, character, or integrity of the individual with respect to whom such notice is submitted indicates that it would not be in the best interest of the members of the credit union or the public to permit the individual to be employed by or associated with, such credit union.

§ 747.903 Procedures Where Notice of Disapproval Issued; Reconsideration.

(a) The notice of disapproval shall be served upon the federally insured credit union and the candidate for director, committee member or senior executive officer. The notice of disapproval shall:

(1) Summarize or cite the relevant consideration specified in § 747.902;

(2) Inform the individual and the credit union that, within 15 days of receipt of the notice of disapproval, they can request reconsideration by the Regional Director of the initial determination, or can appeal the determination directly to the NCUA Board;

(3) Specify what additional information, if any, must be considered in the reconsideration.

(b) The request for reconsideration by the Regional Director must be filed at the appropriate Regional Office.

(c) The Regional Director shall act on a request for reconsideration within 30 days of its receipt.

§ 747.904 Appeal.

(a) Time for filing. Within 15 days after issuance of a Notice of Disapproval or a determination on a request for reconsideration by the Regional Director, the individual or credit union (henceforth petitioner) may appeal by filing with the NCUA Board a written request for appeal.

(b) Contents of request. Any appeal must be in writing and include:

(1) The reasons why the NCUA Board should review the disapproval; and

(2) Relevant, substantive and material facts that for good cause were not previously set forth in the notice required to be filed pursuant to Section 212 of the Act (12 U.S.C. 1790a) and § 701.14 of this Chapter.

(c) Procedures for review of request. Within 30 days of the NCUA Board's receipt of an appeal, the NCUA Board may request in writing that the petitioner submit additional facts and records to support the appeal. The petitioner shall have 15

days from the date of issuance of such written request to provide such additional information. Failure by the petitioner to provide additional information may, as determined solely by the NCUA Board or its designee, result in denial of the petitioner's appeal.

(d) Determination on appeal by NCUA Board or its designee.

(1) Within 90 days from the date of the receipt of an appeal by the NCUA Board or its designee or of its receipt of additional information requested under paragraph (c) of this Section, the NCUA Board or its designee shall notify the petitioner whether the disapproval will be continued, terminated, or otherwise modified. The NCUA Board or its designee shall promptly rescind or modify the notice of disapproval where the decision is favorable to the petitioner.

(2) The determination by the NCUA Board on the appeal shall be provided to the petitioner in writing, stating the basis for any decision of the NCUA Board or its designee that is adverse to the petitioner, and shall constitute a final order of the NCUA Board.

(3) Failure by the NCUA Board to issue a determination on the petitioner's appeal within the 90-day period prescribed under paragraph (d)(1) of this Section shall be deemed a denial of the appeal for purpose of § 747.905.

§ 747.905 Judicial Review.

(a) Failure to file an appeal within the applicable time periods, either to the initial determination or to the decision on request for reconsideration, shall constitute a failure by the petitioner to exhaust available administrative remedies and, due to such failure, any objections to the initial determination or request for reconsideration shall be deemed to be waived and such determination shall be deemed to have been accepted by, and shall be binding upon, the petitioner.

(b) For purposes of seeking judicial review of actions taken pursuant to this Section, suit may be filed in the United States District Court for the district where the requester resides, for the district where the credit union's principal place of business is located, or for the District of Columbia.

Subpart K—Inflation Adjustment of Civil Monetary Penalties

§ 747.1001 Adjustment of civil money penalties by the rate of inflation.

(a) NCUA is required by the Federal Civil Penalties Inflation Adjustment Act of 1990 (Public Law 101–410, 104 Stat. 890, as amended (28 U.S.C. 2461 note)) to adjust the maximum amount of each civil money penalty within its jurisdiction by the rate of inflation. The following chart displays those adjustments, as calculated pursuant to the statute:

U.S. Code citation	CMP description	New maximum amount
(1) 12 U.S.C. 1782(a)(3)	Inadvertent failure to submit a report or the inadvertent submission of a false or misleading report.	$22,000.
(2) 12 U.S.C. 1782(a)(3)	Non-inadvertent failure to submit a report or the non-inadvertent submission of a false or misleading report.	$22,000.
(3) 12 U.S.C. 1782(a)(3)	Failure to submit a report or the submission of a false or misleading report done knowingly or with reckless disregard.	$1,175,000 or 1 percent of the total assets of the credit union, whichever is less.
(4) 12 U.S.C. 1782(d)(2)(A) ...	First tier	$2,200.
(5) 12 U.S.C. 1782(d)(2)(B) ...	Second tier	$22,000.
(6) 12 U.S.C. 1782(d)(2)(C) ...	Third tier	$1,175,000 or 1 percent of the total assets of the credit union, whichever is less.
(7) 12 U.S.C. 1785(e)(3)	Non-compliance with NCUA security regulations ...	$110.
(8) 12 U.S.C. 1786(k)(2)(A)	First tier	$6,500.
(9) 12 U.S.C. 1786(k)(2)(B)	Second tier	$32,500.

Part 748

Security Program, Report of Crime and Catastrophic Act and Bank Secrecy Act Compliance

§ 748.0 Security program.

(a) Each federally-insured credit union will develop a written security program within 90 days of the effective date of insurance.

(b) The security program will be designed to:

(1) Protect each credit union office from robberies, burglaries, larcenies, and embezzlement;

(2) Ensure the security and confidentiality of member records, protect against anticipated threats or hazards to the security or integrity of such records, and protect against unauthorized access to or use of such records that could result in substantial harm or serious inconvenience to a member;

(3) Assist in the identification of persons who commit or attempt such actions and crimes; and

(4) Prevent destruction of vital records, as defined in 12 CFR part 749.

(c) Each Federal credit union, as part of its information security program, must properly dispose of any consumer information the Federal credit union maintains or otherwise possesses, as required under § 717.83 of this chapter.

§ 748.1 Filing of reports.

(a) *Compliance Report.* Each federally-insured credit union shall file with the regional director an annual statement certifying its compliance with the requirements of this Part. The statement shall be dated and signed by the president or other managing officer of the credit union. The statement is contained on the Report of Officials which is submitted annually by federally-insured credit unions after the election of officials. In the case of federally-insured state-chartered credit unions, this statement can be mailed to the regional director via the state supervisory authority, if desired. In any event, a copy of the statement shall always be sent to the appropriate state supervisory authority.

(b) *Catastrophic Act Report.* Each federally-insured credit union will notify the regional director within 5 business days of any catastrophic act that occurs at its office(s). A catastrophic act is any natural disaster such as a flood, tornado, earthquake, etc., or major fire or other disaster resulting in some physical destruction or damage to the credit union. Within a reasonable time after a catastrophic act occurs, the credit union shall ensure that a record of the incident is prepared and filed at its main office. In the preparation of such record, the credit union should include information sufficient to indicate the office where the catastrophic act occurred; when it took place; the amount of the loss, if any; whether any operational or mechanical deficiency(ies) might have contributed to the catastrophic act; and what has been done or is planned to be done to correct the deficiency(ies).

(c) *Suspicious Activity Report.* (1) Each federally-insured credit union will report any crime or suspected crime that occurs at its office(s), utilizing NCUA Form 2362, Suspicious Activity Report (SAR), within thirty calendar days after discovery. Each federally-insured credit union must follow the instructions and reporting requirements accompanying the SAR. Copies of the SAR may be obtained from the appropriate NCUA Regional Office.

(2) Each federally-insured credit union shall maintain a copy of any SAR that it files and the original of all attachments to the report for a period of five years from the date of the report, unless the credit union is informed in writing by the National Credit Union Administration that the materials may be discarded sooner.

(3) Failure to file a SAR in accordance with the instructions accompanying the report may subject the federally-insured credit union, its officers, directors, agents or other institution-affiliated parties to the assessment of civil money penalties or other administrative actions.

(4) Filing of Suspicious Activity Reports will ensure that law enforcement agencies and NCUA are promptly notified of actual or suspected crimes. Information contained on SARs will be entered into an interagency database and will assist the federal government in taking appropriate action.

§ 748.2 Procedures for monitoring Bank Secrecy Act (BSA) compliance.

(a) *Purpose.* This Section is issued to ensure that all federally-insured credit unions establish and maintain procedures reasonably designed to assure and monitor compliance with the requirements of Subchapter II of Chapter 53 of Title 31, United States Code, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act, and the implementing regulations promulgated thereunder by the Department of Treasury, 31 C.F.R. Part 103.

(b) *Establishment of a BSA compliance program.* (1) *Program requirement.* Each federally-insured credit union shall develop and provide for the continued administration of a program reasonably designed to assure and monitor compliance with the recordkeeping and recording requirements set forth in subchapter II of chapter 53 of title 31, United States Code and the implementing regulations issued by the Department of the Treasury at 31 CFR part 103. The compliance program must be written, approved by the credit union's board of directors, and reflected in the minutes of the credit union.

(2) *Customer identification program.* Each federally-insured credit union is subject to the requirements of 31 U.S.C. 5318(l) and the implementing regulation jointly promulgated by the NCUA and the Department of the Treasury at 31 CFR 103.121, which require a customer identification program to be implemented as part of the BSA compliance program required under this section.

(c) *Contents of Compliance Program.* Such compliance program shall at a minimum—

(1) Provide for a system of internal controls to assure ongoing compliance;

(2) Provide for independent testing for compliance to be conducted by credit union personnel or outside parties;

(3) Designate an individual responsible for coordinating and monitoring day-to-day compliance; and

(4) Provide training for appropriate personnel.

Appendix A to Part 748—Guidelines for Safeguarding Member Information

Table of Contents

I. Introduction

The Guidelines for Safeguarding Member Information (Guidelines) set forth standards pursuant to sections 501 and 505(b), codified at 15 U.S.C. 6801 and 6805(b), of the Gramm-Leach-Bliley Act. These Guidelines provide guidance standards for developing and implementing administrative, technical, and physical safeguards to protect the security, confidentiality, and integrity of member information. These Guidelines also address standards with respect to the proper disposal of consumer information pursuant to sections 621(b) and 628 of the Fair Credit Reporting Act (15 U.S.C. 1681s(b) and 1681w).

A. *Scope.* The Guidelines apply to member information maintained by or on behalf of federally-insured credit unions. Such entities are referred to in this appendix as "the credit union." These Guidelines also apply to the proper disposal of consumer information by such entities.

B. *Definitions.* 1. *In general.* Except as modified in the Guidelines or unless the context otherwise requires, the terms used in these Guidelines have the same meanings as set forth in 12 CFR part 716.

2. For purposes of the Guidelines, the following definitions apply:

a. *Consumer information* means any record about an individual, whether in paper, electronic, or other form, that is a consumer report or is derived from a consumer report and that is maintained or otherwise possessed by or on behalf of the credit union for a business purpose. Consumer information also means a compilation of such records. The term does not include any record that does not identify an individual.

b. *Consumer report* has the same meaning as set forth in the Fair Credit Reporting Act, 15 U.S.C. 1681a(d). The meaning of consumer report is broad and subject to various definitions, conditions and exceptions in the Fair Credit Reporting Act. It includes written or oral communications from a consumer reporting agency to a third party of information used or collected for use in establishing eligibility for credit or insurance used primarily for personal, family or household purposes, and eligibility for employment purposes. Examples include credit reports, bad check lists, and tenant screening reports.

c. *Member* means any member of the credit union as defined in 12 CFR 716.3(n).

d. *Member information* means any records containing nonpublic personal information, as defined in 12 CFR 716.3(q), about a member, whether in paper, electronic, or other form, that is maintained by or on behalf of the credit union.

e. *Member information system* means any method used to access, collect, store, use, transmit, protect, or dispose of member information.

f. *Service provider* means any person or entity that maintains, processes, or otherwise is permitted access to member information through its provision of services directly to the credit union.

II. Standards for Safeguarding Member Information

A. *Information Security Program.* A comprehensive written information security program includes administrative, technical, and physical safeguards appropriate to the size and complexity of the credit union and the nature and scope of its activities. While all parts of the credit union are not required to implement a uniform set of policies, all elements of the information security program must be coordinated.

B. *Objectives.* A credit union's information security program should be designed to: ensure the security and confidentiality of member information; protect against any anticipated threats

or hazards to the security or integrity of such information; and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any member; and ensure the proper disposal of member information and consumer information. Protecting confidentiality includes honoring members' requests to opt out of disclosures to nonaffiliated third parties, as described in 12 CFR 716.1(a)(3).

III. Development and Implementation of Member Information Security Program

A. *Involve the Board of Directors.* The board of directors or an appropriate committee of the board of each credit union should:

1. Approve the credit union's written information security policy and program; and

2. Oversee the development, implementation, and maintenance of the credit union's information security program, including assigning specific responsibility for its implementation and reviewing reports from management.

B. *Assess Risk.* Each credit union should:

1. Identify reasonably foreseeable internal and external threats that could result in unauthorized disclosure, misuse, alteration, or destruction of member information or member information systems;

2. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of member information; and

3. Assess the sufficiency of policies, procedures, member information systems, and other arrangements in place to control risks.

C. *Manage and Control Risk.* Each credit union should:

1. Design its information security program to control the identified risks, commensurate with the sensitivity of the information as well as the complexity and scope of the credit union's activities. Each credit union must consider whether the following security measures are appropriate for the credit union and, if so, adopt those measures the credit union concludes are appropriate:

a. Access controls on member information systems, including controls to authenticate and permit access only to authorized individuals and controls to prevent employees from providing member information to unauthorized individuals who may seek to obtain this information through fraudulent means;

b. Access restrictions at physical locations containing member information, such as buildings, computer facilities, and records storage facilities to permit access only to authorized individuals;

c. Encryption of electronic member information, including while in transit or in storage on networks or systems to which unauthorized individuals may have access;

d. Procedures designed to ensure that member information system modifications are consistent with the credit union's information security program;

e. Dual controls procedures, segregation of duties, and employee background checks for employees with responsibilities for or access to member information;

f. Monitoring systems and procedures to detect actual and attempted attacks on or intrusions into member information systems;

g. Response programs that specify actions to be taken when the credit union suspects or detects that unauthorized individuals have gained access to member information systems, including appropriate reports to regulatory and law enforcement agencies; and

h. Measures to protect against destruction, loss, or damage of member information due to potential environmental hazards, such as fire and water damage or technical failures.

2. Train staff to implement the credit union's information security program.

3. Regularly test the key controls, systems and procedures of the information security program. The frequency and nature of such tests should be determined by the credit union's risk assessment. Tests should be conducted or reviewed by independent third parties or staff independent of those that develop or maintain the security programs.

4. Develop, implement, and maintain, as part of its information security program, appropriate measures to properly dispose of member information and consumer information in accordance with the provisions in paragraph III.

D. *Oversee Service Provider Arrangements.* Each credit union should:

1. Exercise appropriate due diligence in selecting its service providers;

2. Require its service providers by contract to implement appropriate measures designed to meet the objectives of these guidelines; and

3. Where indicated by the credit union's risk assessment, monitor its service providers to confirm that they have satisfied their obliga-

tions as required by paragraph D.2. As part of this monitoring, a credit union should review audits, summaries of test results, or other equivalent evaluations of its service providers.

E. *Adjust the Program.* Each credit union should monitor, evaluate, and adjust, as appropriate, the information security program in light of any relevant changes in technology, the sensitivity of its member information, internal or external threats to information, and the credit union's own changing business arrangements, such as mergers and acquisitions, alliances and joint ventures, outsourcing arrangements, and changes to member information systems.

F. *Report to the Board.* Each credit union should report to its board or an appropriate committee of the board at least annually. This report should describe the overall status of the information security program and the credit union's compliance with these guidelines. The report should discuss material matters related to its program, addressing issues such as: risk assessment; risk management and control decisions; service provider arrangements; results of testing; security breaches or violations and management's responses; and recommendations for changes in the information security program.

G. *Implement the Standards.*

1. *Effective date.* Each credit union must implement an information security program pursuant to the objectives of these Guidelines by July 1, 2001.

2. *Two-year grandfathering of agreements with service providers.* Until July 1, 2003, a contract that a credit union has entered into with a service provider to perform services for it or functions on its behalf satisfies the provisions of paragraph III.D., even if the contract does not include a requirement that the servicer maintain the security and confidentiality of member information, as long as the credit union entered into the contract on or before March 1, 2001.

3. *Effective date for measures relating to the disposal of consumer information.* Each Federal credit union must properly dispose of consumer information in a manner consistent with these Guidelines by July 1, 2005.

4. *Exception for existing agreements with service providers relating to the disposal of consumer information.* Notwithstanding the requirement in paragraph III.G.3., a Federal credit union's existing contracts with its service providers with regard to any service involving the disposal of consumer information should implement the objectives of these Guidelines by July 1, 2006.

(e) A copy of the notice to the submitter will also be provided to the FOIA requester.

(f) Through the notice described in paragraph (d) of this section, NCUA will afford the submitter a reasonable period of time within which to provide a detailed written statement of any objection to disclosure. The statement must describe why the information is confidential commercial information and why it should not be disclosed.

(g) Whenever we decide that we must disclose confidential commercial information over the objection of the submitter, we will send both the submitter and the FOIA requester, within a reasonable number of days prior to the specified disclosure date, a written notice which will include:

(1) A statement of the reasons for which the submitter's disclosure objection was not sustained; and

(2) A description of the information to be disclosed; and

(3) A specified disclosure date.

(h) If a requester brings suit to compel disclosure of confidential commercial information, we will promptly notify the submitter.

(i) The notice requirements of paragraph (d) of this section do not apply if:

(1) We determine that the information should not be disclosed;

(2) The information has been lawfully published or has been officially made available to the public;

(3) Disclosure of the information is required by law; or

(4) The designation made by the submitter in accordance with paragraph (c) of this section appears obviously frivolous; except that in such case, NCUA will provide the submitter with written notice of any final administrative decision to disclose the information within a reasonable number of days prior to the specified disclosure date.

Release of Exempt Information

§ 792.30 Is there a prohibition against disclosure of exempt records?

Except those authorized officials listed in § 792.14, or as provided in §§ 792.31–792.32, and subpart C of this part, no officer, employee, or agent of NCUA or of any federally-insured credit union shall disclose or permit the disclosure of any exempt records of NCUA to any person other than those NCUA or credit union officers, employees, or agents properly entitled to such information for the performance of their official duties.

§ 792.31 Can exempt records be disclosed to credit unions, financial institutions and state or federal agencies?

The NCUA Board, in its sole discretion, or any person designated by it in writing, may make available to certain governmental agencies and insured financial institutions copies of reports of examination and other documents, papers or information for their use, when necessary, in the performance of their official duties or functions. All reports, documents and papers made available pursuant to this paragraph shall remain the property of NCUA. No person, agency or employee shall disclose the reports or exempt records without NCUA's express written authorization.

§ 792.32 Can exempt records be disclosed to investigatory agencies?

The NCUA Board, or any person designated by it in writing, in its discretion and in appropriate circumstances, may disclose to proper federal or state authorities copies of exempt records pertaining to irregularities discovered in credit unions which may constitute either unsafe or unsound practices or violations of federal or state, civil or criminal law.

Subpart B—Reserved

Subpart C—Production of Nonpublic Records and Testimony of NCUA Employees in Legal Proceedings

§ 792.40 What does this subpart prohibit?

This subpart prohibits the release of nonpublic records or the appearance of an NCUA employee to testify in legal proceedings except as provided in this subpart. Any person possessing nonpublic records may release them or permit their disclosure only as provided in this subpart.

(a) *Duty of NCUA employees.* (1) If an NCUA employee is served with a subpoena requiring him or her to appear as a witness or produce records, the employee must promptly notify the Office of

General Counsel. The General Counsel has the authority to instruct NCUA employees to refuse appearing as a witness or to withhold nonpublic records. The General Counsel may let an NCUA employee provide testimony, including expert or opinion testimony, if the General Counsel determines that the need for the testimony clearly outweighs contrary considerations.

(2) If a court or other appropriate authority orders or demands expert or opinion testimony or testimony beyond authorized subjects contrary to the General Counsel's instructions, an NCUA employee must immediately notify the General Counsel of the order and respectfully decline to comply. An NCUA employee must decline to answer questions on the grounds that this subpart forbids such disclosure and should produce a copy of this subpart, request an opportunity to consult with the Office of General Counsel, and explain that providing such testimony without approval may expose him or her to disciplinary or other adverse action.

(b) *Duty of persons who are not NCUA employees.* (1) If you are not an NCUA employee but have custody of nonpublic records and are served with a subpoena requiring you to appear as a witness or produce records, you must promptly notify the NCUA about the subpoena. Also, you must notify the issuing court or authority and the person or entity for whom the subpoena was issued of the contents of this subpart. Notice to the NCUA is made by sending a copy of the subpoena to the General Counsel of the NCUA, Office of General Counsel, 1775 Duke Street, Alexandria, Virginia 22314–3428. After receiving notice, the NCUA may advise the issuing court or authority and the person or entity for whom the subpoena was issued that this subpart applies and, in addition, may intervene, attempt to have the subpoena quashed or withdrawn, or register appropriate objections.

(2) After notifying the Office of General Counsel, you should respond to a subpoena by appearing at the time and place stated in the subpoena. Unless authorized by the General Counsel, you should decline to produce any records or give any testimony, basing your refusal on this subpart. If the issuing court or authority orders the disclosure of records or orders you to testify, you should continue to decline to produce records or testify and should advise the Office of General Counsel.

(c) *Penalties.* Anyone who discloses nonpublic records or gives testimony related to those records, except as expressly authorized by the NCUA or as ordered by a federal court after NCUA has had the opportunity to be heard, may face the penalties provided in 18 U.S.C. 641 and other applicable laws. Also, former NCUA employees, in addition to the prohibition contained in this subpart, are subject to the restrictions and penalties of 18 U.S.C. 207.

§ 792.41 When does this subpart apply?

This subpart applies if you want to obtain nonpublic records or testimony of an NCUA employee for legal proceedings. It doesn't apply to the release of records under the Freedom of Information Act (FOIA), 5 U.S.C. 552, or the Privacy Act, 5 U.S.C. 552a, or the release of records to federal or state investigatory agencies under § 792.32.

§ 792.42 How do I request nonpublic records or testimony?

(a) To request nonpublic records or the testimony of an NCUA employee, you must submit a written request to the General Counsel of the NCUA. If you serve a subpoena on the NCUA or an NCUA employee before submitting a written request and receiving a final determination, the NCUA will oppose the subpoena on the grounds that you failed to follow the requirements of this subpart. You may serve a subpoena as long as it is accompanied by a written request that complies with this subpart.

(b) To request nonpublic records that are part of the records of the Office of the Inspector General or the testimony of an NCUA employee on matters within the knowledge of the NCUA employee as a result of his or her employment with the Office of the Inspector General, you must submit a written request to the Office of the Inspector General. Your request will be handled in accordance with the provisions of this subpart except that the Inspector General will be responsible for those determinations that would otherwise be made by the General Counsel.

§ 792.43 What must my written request contain?

Your written request for records or testimony must include:

(a) The caption of the legal proceeding, docket number, and name of the court or other authority involved.

(b) A copy of the complaint or equivalent document setting forth the assertions in the case and any other pleading or document necessary to show relevance.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 701 and 742

Federal Credit Union Ownership of Fixed Assets

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) Board is issuing final revisions to its fixed asset rule. The fixed asset rule governs Federal credit union (FCU) ownership of fixed assets and, among other things, limits investment in fixed assets to five percent of an FCU's shares and retained earnings. This final rule clarifies and reorganizes the requirements of the current rule to make it easier to understand. The only substantive changes in the final rule are to: Eliminate the requirement that an FCU, when calculating its investment in fixed assets, include its investments in any entity that holds fixed assets used by the FCU; and establish a time frame for submission of requests for waiver of the requirement for partial occupation of premises acquired for future expansion.

DATES: This rule is effective October 29, 2004.

FOR FURTHER INFORMATION CONTACT: Paul Peterson, Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Federal Credit Union Act authorizes an FCU to purchase, hold, and dispose of property necessary or incidental to its operations. 12 U.S.C. 1757(4). Generally, an FCU may only invest in property it intends to use to transact credit union business, that is, to support its internal operations or serve its members. 12 CFR 721.3(d). NCUA's fixed asset rule limits an FCU's investment in fixed assets and imposes requirements on the planning for, use of, and disposal of real property acquired for future expansion. 12 CFR 701.36.

The NCUA Board has a policy of continually reviewing NCUA regulations to ''update, clarify and simplify existing regulations and eliminate redundant and unnecessary provisions.'' NCUA Interpretive Ruling and Policy Statement (IRPS) 87–2, Developing and Reviewing Government Regulations. As a result of the NCUA's 2003 review, the Board determined that the fixed asset rule should be updated. In April, 2004, the Board published its proposed updates for public comment. 69 FR 21439 (April 21, 2004).

B. Section-by-Section Analysis of the Final Rule

This final rule does not vary significantly from the proposed rule. Like the proposed rule, the only substantive revisions in the final rule from the current rule are to (1) eliminate the requirement that an FCU, when calculating its investment in fixed assets, include its investments in any entity that holds fixed assets used by the FCU, and (2) establish a time frame for submission of requests for waiver of the requirement for partial occupation of premises acquired for future expansion. The final rule also reorganizes the paragraph structure and clarifies the provisions governing an FCU's plans for future expansion into fixed assets. A section-by-section analysis of these revisions follows.

Section 701.36(a)

The final rule renumbers § 701.36(c), Investment in Fixed Assets, as § 701.36(a). The final rule retains the requirement that FCUs with $1,000,000 or more in assets cannot invest in fixed assets if the investment would cause the aggregate of all the FCU's fixed assets to exceed five percent of the FCU's shares and retained earnings. The final rule retains the waiver process that allows FCUs to apply for a waiver of the five percent limitation and reorganizes the waiver provisions to simplify them and make them easier to follow.

Section 701.36(b)

The final rule renumbers § 701.36(d), Premises, to § 701.36(b). This paragraph contains provisions on real property owned by an FCU that is not currently used to transact credit union business.

The final rule changes the title of this paragraph to ''Premises Not Currently Used to Transact Credit Union Business'' to better indicate its scope.

The final rule clarifies that requests for waiver of the partial occupation requirement must be in writing and submitted to NCUA within 30 months of acquisition of the premises. The final rule also clarifies that partial use occurs when FCU staff occupy some part of the space on a full-time basis.

The final clarifies that, after real property acquired for future expansion has been held for one year, a board resolution with definitive plans for full utilization must be available for inspection by an NCUA examiner. The final rule also clarifies that full use occurs when the premises are completely occupied by the FCU, or by some combination of the FCU, credit union service corporations (CUSOs), and credit union vendors, on a full-time basis. CUSO and vendor activities must be primarily to support the operations of the FCU or serve its members.

The final rule clarifies and simplifies the provisions on abandoned premises. The final rule revises the provision that an FCU ''shall endeavor to dispose of ''abandoned premises'' at a price sufficient to reimburse the FCU for its investment and costs of acquisition'' to state that an FCU must seek fair market value for the property.

Section 701.36(c)

The final rule renumbers § 701.36(e), Prohibited Transactions, to § 701.36(c). The rule retains the prohibition on an FCU acquiring or leasing property (without the prior approval of NCUA) from the FCU's insiders, their family members, or corporations and partnerships in which the insider has a significant ownership interest. To ensure that all business forms are covered, the rule adds limited liability companies and ''other entities'' to this list.

Section 701.36(d)

FCUs that qualify for the Regulatory Flexibility (RegFlex) Program are exempt from the five percent limitation on investment in fixed assets. 12 CFR part 742. Accordingly, the final rule adds a new paragraph (d) to § 701.36 with a cross-reference to the RegFlex Program. The rule also reiterates that FCUs that once qualified for the RegFlex Program and its associated exemptions but no longer qualify for RegFlex must comply with all the provisions of the fixed asset rule.

Section 701.36(e)

The final rule renumbers § 701.36(b), Definitions, to § 701.36(e). The rule retains the definition of ''investment in fixed assets'' found in subparagraph (4), but deletes the subparagraph (4)(iv) portion of the definition that includes any investments in, and loans to, a partnership or corporation, including a CUSO, that holds any fixed assets used by the FCU. This portion of the definition is unnecessary and, in some cases, may cause investment in fixed assets to be overstated.

The final rule revises the definition of ''retained earnings'' in subparagraph (7) to mean ''undivided earnings, regular reserve, reserve for contingencies, supplemental reserves, reserve for losses, and other appropriations from undivided earnings as designated by management or the Administration.'' The revision recognizes that reserve

accounts may be created out of undivided earnings consistent with generally accepted accounting principles. The rule also separates the definitions of ''shares'' and ''retained earnings'' and alphabetizes all the definitions to make them easier to locate.

Section 742.4(a)

The final rule includes a technical amendment to the RegFlex Program rule reflecting the restructuring of the fixed asset rule.

C. Public Comments

NCUA received 12 comment letters regarding the proposed rule. Almost all the commenters expressed general agreement with the proposed rule, and, in particular, the clarifications and simplifications. Most of the commenters expressed appreciation for NCUA's policy of reviewing its regulations at least once every three years. Summaries of the comments and the Board's reaction follow.

Amendment to Definition of Fixed Asset

Almost all the commenters agree with the change in the definition of fixed asset to exclude investments in entities that hold fixed assets used by the FCU.

One commenter believes that lease payments for fixed assets should also be excluded from the calculation of the fixed asset limit. The Board does not want to exclude lease payments. The Board's longstanding position is that an FCU can over-invest in fixed assets through binding lease arrangements just as it can over-invest through outright ownership. See, for example, the preamble to the 1989 final fixed asset rule. 54 FR 18466 (May 1, 1989).

Clarification of ''Partially Occupy'' and ''Fully Occupy'' and Associated Time Frames

The proposed rule sought to clarify that premises were considered partially occupied when the credit union is using some part of the space on a full-time basis and fully occupied when the credit union, or a combination of the credit union, CUSOs, or vendors, use the entire space on a full-time basis. Almost all the commenters agreed that the clarifications were helpful.

Most commenters believe it is reasonable that credit unions intending to seek a waiver of the requirement for partial occupation of premises within three years should file the request for waiver within 30 months. One commenter asks that, instead of 30 months, the request for waiver be filed within 35 months, one month before the expiration of the three-year period. One commenter objects to the waiver provision and believes it should be eliminated. This commenter is particularly concerned that a credit union that loses its eligibility for the RegFlex Program should not be granted a waiver.

The final rule retains the 30-month notice requirement. Thirty months seems a reasonable amount of time to prepare a waiver request. The Board also believes that the Regional Director should have flexibility to grant waivers in appropriate cases, and the final rule retains this waiver authority.

Several commenters believe NCUA should reduce or eliminate the rule's requirements for both partial and full occupation, but particularly for full occupation. These commenters contend it is difficult for a credit union to obtain a building or lease space that is a perfect fit for the credit union's current and near term plans and the rule's occupation requirements restrict credit union growth and may be anticompetitive. One commenter cites the perceived difficulty rural and low-income credit unions have in finding appropriate office space, and another cites the perceived difficulty a continuing credit union in a merger has in balancing reduced staffing needs with the buildings it inherits in a merger. Another commenter stated that office construction projects take more than three years from first planning to building occupation and that it is ''impractical to write a regulation that will inevitably require a waiver.'' A few commenters also believe credit unions eligible for the RegFlex program should be exempt from any requirements to fully occupy a building because of the lack of safety and soundness concerns for these credit unions. Two commenters cite with approval the Office of the Comptroller of the Currency's (OCC's) approach to real estate owned by national banks. The OCC requires partial occupation of bank-owned real estate but not always full occupation.

The Board recognizes the difficulties associated with the management of real estate and other fixed assets but believes that the fixed asset rule, as revised by this rulemaking, provides maximum flexibility to FCUs within the bounds of the law and safety and soundness. Federal credit unions are chartered for the purpose of providing financial services to their members and it is not permissible for them to engage in real estate activities that do not support that purpose.

While it may sometimes be difficult for credit unions to find real estate to fit their needs or to downsize real estate holdings following a merger, the Board believes the rule provides enough flexibility to meet various circumstances. The rule allows an FCU to own or lease premises it will not occupy immediately but needs for future expansion and gives FCUs significant leeway on how to achieve both partial and full occupation. For example, there is no set time period within which an FCU must achieve full occupation. While the rule requires an FCU to develop a definitive plan for full occupation, it has an entire year after it acquires property to develop the plan. Further, with regard to partial occupation, the rule permits FCUs to hold real estate for significant periods of time—up to three years—before the FCU has to occupy *any* of the space. If an FCU needs additional time beyond three years to achieve partial occupation, it may request approval for additional time from its Regional Director. The Board believes that it would be unusual, even when an FCU is constructing its own premises, for the FCU not to achieve partial occupation within three years. Still, if the construction process will take more than three years, a waiver is appropriate and the credit union should obtain it before binding itself contractually to the project.

The Board is aware that the Office of the Comptroller of the Currency has a different view of the powers of national banks under the National Bank Act, but the Board has concluded, for both legal and safety and soundness reasons, that FCUs may not lease real estate to unrelated third parties indefinitely. As noted above, the acquisition of real estate and other fixed assets must support the provision of financial services to credit union members and the Board believes the rule provides significant and sufficient flexibility for FCUs in how they address any excess capacity they may have in fixed assets they acquire.

Fixed Asset Limitation

The current rule limits an FCU's fixed assets to five percent of shares and retained earnings. Credit unions eligible for the RegFlex Program are exempt from this limitation and there is a waiver process that other credit unions may use to avoid the five percent limitation.

A few commenters are concerned with the proposed rule's clarification that credit unions that lose their eligibility for the regulatory flexibility program must again comply with the fixed asset rule's five percent limitation. One commenter suggests that a credit union that loses its status have up to five years to dispose of fixed assets,

citing a similar time frame in the rule for disposition of abandoned premises. Another commenter suggests that credit unions with less than 9% net worth should have their RegFlex Program status extended for purposes of compliance with the fixed asset limitation even if they lose their RegFlex status for other purposes. One commenter suggests that NCUA apply the 5% limit on fixed assets to credit unions that have a 7% or less net worth ratio, and that NCUA modify its rule to increase the limit in direct proportion to the amount that the net worth ratio exceeds 7%. Another commenter believes the ratio of fixed assets to a combination of deposits and capital is not a meaningful test of prudent management.

In addressing these comments, the Board first wishes to clarify a statement made in the preamble of the proposed rule. The preamble stated that an FCU eligible for the RegFlex Program with fixed assets exceeding five percent of shares and retained earnings and that subsequently loses its RegFlex eligibility must either reduce its fixed asset holdings below the five percent level or obtain a waiver. The RegFlex Program regulation, however, has a grandfather provision that states:

> Any action by the credit union under the RegFlex authority will be grandfathered. Any actions subsequent to losing the RegFlex authority must meet NCUA's regulatory requirements. This does not diminish NCUA's authority to require a credit union to divest its investments or assets for substantive safety and soundness reasons.

12 CFR 742.8. Accordingly, an FCU that loses its RegFlex eligibility and finds itself with fixed assets exceeding five percent of shares and retained earnings does not have to divest itself of any fixed assets unless NCUA affirmatively orders it to do so for safety and soundness reasons. If the FCU wants to acquire additional fixed assets, the FCU will need a waiver from the Regional Director before the acquisition if, after acquisition, the FCU would exceed the five percent limit. The Board has amended the final rule text to reflect this more clearly.

As stated above, a few commenters request modification of the five percent limit for FCUs that lose their RegFlex eligibility. The Board does not believe these credit unions need any special variance from the five percent limit. A Regional Director has authority to grant waivers and set conditions on those waivers. For FCUs that lose RegFlex eligibility and have or want fixed assets that would put them over the five percent limit, a Regional Director has authority to establish appropriate fixed asset levels on a case-by-case basis.

D. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small entities (those credit unions under ten million dollars in assets). NCUA believes that, under the current rule, the only burden imposed on small credit unions is the requirement to submit a waiver request if investment in fixed assets exceeds 5% of retained shares and earnings. There are presently about 4,500 small, federally-insured credit unions. Each year, only about ten of these credit unions submit a waiver request, and NCUA estimates each waiver request takes about ten hours to prepare. Accordingly, and as stated in the preamble to the proposed rule, NCUA does not believe the rule imposes a significant economic impact on a substantial number of small entities and no flexibility analysis is required. NCUA received no comments about this conclusion.

Paperwork Reduction Act

The proposed rule requested comment on the information collection requirements contained in the fixed asset rule and advised that NCUA was seeking the reinstatement of Collection of Information, FCU Ownership of Fixed Assets, Control Number 3133–0040. No comments were received. On July 7, 2004, the Office of Management and Budget (OMB) approved the reinstatement of Control Number 3133–0040, with revisions as proposed and an expiration date of July 31, 2007.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects

12 CFR Part 701

Credit unions.

12 CFR Part 742

Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on September 23, 2004.

Mary Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 747

Civil Monetary Penalty Inflation Adjustment

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: Congress, in the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended by the Debt Collection Improvement Act of 1996, required all federal agencies with the authority to impose civil monetary penalties (CMPs) to regularly evaluate those CMPs to ensure that they continue to maintain their deterrent value. In order to comply with Congress' mandate to adjust CMPs for inflation at least every four years, NCUA is issuing this final rule to implement the required adjustments to the CMPs authorized by the Federal Credit Union Act and other relevant laws.

DATES: Effective November 1, 2004.

FOR FURTHER INFORMATION CONTACT: Allan Meltzer, Associate General Counsel, or Jon Canerday, Trial Attorney, Office of General Counsel, NCUA, 1775 Duke Street, Alexandria, Virginia 22314, or telephone (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Debt Collection Improvement Act of 1996 [1] (DCIA) amended the Federal Civil Penalties Inflation Adjustment Act of 1990 [2] (FCPIA Act) to require every Federal agency to enact regulations that adjust each civil monetary penalty (CMP) [3] provided by law under its jurisdiction by the rate of inflation pursuant to the inflation adjustment formula in section 5(b) of the FCPIA Act. Each Federal agency was required to issue these implementing regulations by October 23, 1996, and at least once every 4 years thereafter. Section 6 of the amended FCPIA Act specifies that inflation-adjusted CMPs will only apply to violations that occur after the effective date of the adjustment. The inflation adjustment is based on the percentage increase in the Consumer Price Index (CPI).[4] Specifically, section 5(b) of the FCPIA Act defines the term ''cost-of-living adjustment'' as ''the percentage (if any) for each civil monetary penalty by which—(1) The Consumer Price Index for the month of June of the calendar year preceding the adjustment, exceeds (2) the Consumer Price Index for the month of June of the calendar year in which the amount of such civil monetary penalty was last set or adjusted pursuant to law.'' Furthermore, each CMP that has been adjusted for inflation must be rounded to a number prescribed by section 5(a) of the FCPIA Act.[5]

The CMPs which NCUA is authorized to impose were last adjusted by NCUA in either 1996 or 2000. For those CMPs that were adjusted in 2000, the current adjustment will be the percentage by which the CPI for the month of June 2003 exceeds the CPI for the month of June 2000. According to the Bureau of Labor Statistics, the CPI for the month of June 2000 was 172.4 and the CPI for the month of June 2003 was 183.7. The percentage by which the 2003 figure exceeds the 2000 figure is 6.55 percent. Thus, the CMPs that were last adjusted in 2000 should be increased by 6.55 percent to arrive at the new adjusted amounts (before required rounding).

For those CMPs that were adjusted in 1996, the current adjustment will be the percentage by which the CPI for the month of June 2003 exceeds the CPI for the month of June 1996. According to the Bureau of Labor Statistics, the CPI for the month of June 1996 was 156.7 and the CPI for the month of June 2003 was 183.7. The percentage by which the 2003 figure exceeds the 1996 figure is 17.23 percent. The CMPs that were last adjusted in 1996 should be increased by 17.23 percent to arrive at the new adjusted amounts (before required rounding).

B. Mathematical Calculations of the Adjustments

1. 12 U.S.C. 1782a(a)(3)

NCUA is authorized to require credit unions to periodically provide reports of condition. The failure to submit a required report or the submission of a false or misleading report subjects a credit union to three levels of CMPs, depending upon the reasons for noncompliance.

Calculation of the Adjustment

The CMPs authorized by 12 U.S.C. 1782a(a)(3) were last adjusted by NCUA in 2000.[6] Therefore, these CMPs should be multiplied by 6.55 percent to arrive at the new adjusted amounts (before required rounding).

The maximum CMP authorized by 12 U.S.C. 1782a(a)(3) for an inadvertent failure to submit a report or the inadvertent submission of a false or misleading report is $2,000 for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for inflation in 2000, the maximum penalty was increased to $2,200 for each day. Multiplying the current penalty of $2,200 by 6.55 percent results in an increase of $144.10. When that number is rounded as required by the FCPIA Act,[7] the inflation-adjusted maximum remains $2,200.

The maximum CMP authorized by 12 U.S.C. 1782a(a)(3) for a non-inadvertent failure to submit a report or the non-inadvertent submission of a false or misleading report is $20,000 for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for inflation in 2000, the maximum penalty was increased to $22,000 for each day. Multiplying the current penalty of $22,000 by 6.55 percent results in an increase of $1,441. When that number is rounded as required by the FCPIA Act,[8] the inflation-adjusted maximum remains $22,000.

The maximum CMP authorized by 12 U.S.C. 1782a(a)(3) for a failure to submit a report or the submission of a false or misleading report done knowingly or with reckless disregard is $1,000,000 or 1 percent of the total assets of the credit union, whichever is less, for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for

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[1] Pub. L. 104–134, 31001(s), 110 Stat. 1321–373, (Apr. 26, 1996). The Provision is codified at 28 U.S.C. 2461 note.

[2] Pub. L. 101–410, 104 Stat. 890, (Oct. 5, 1990), also codified at 28 U.S.C. 2461 note.

[3] Section 3(2) of the amended FCPIA Act defines a CMP as any penalty, fine, or other sanction that: (1) Either is for a specific monetary amount as provided by Federal law or has a maximum amount provided for by Federal law; (2) is assessed or enforced by an agency pursuant to Federal law; and (3) is assessed or enforced pursuant to an administrative proceeding or a civil action in the Federal courts.

[4] The CPI is published by the Department of Labor, Bureau of Statistics, and is available at its Web site: *http://data.bls.gov/cgi-bin/surveymost.*

[5] In 2000, NCUA recognized that the rounding provision of the FCPIA Act was capable of differing interpretations. Since then, the Comptroller General has interpreted the rounding requirements of the FCPIA Act the same way as NCUA did in calculating the 2000 inflation adjustments. Comp. Gen. B–290021, 2002 U.S. Comp. Gen. LEXIS 266, July 15, 2002.

[6] The previous inflation adjustments were made to 12 U.S.C. 1782. That provision has been redesignated as 1782a.

[7] ''Any increase determined under this subsection shall be rounded to the nearest– * * * (3) multiple of $1,000 in the case of penalties greater than $1,000 but less than or equal to $10,000.'' Section 5(a), FCPIA Act. Therefore, $144.10 is rounded to the nearest multiple of $1,000 or to $0.

[8] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (4) multiple of $5,000 in the case of penalties greater than $10,000 but less than or equal to $100,000.'' Section 5(a), FCPIA Act. Therefore, $1,441 is rounded to the nearest multiple of $5,000 or to $0.

inflation in 2000, the maximum penalty was increased to $1,100,000 for each day. Multiplying the current penalty of $1,100,000 by 6.55 percent results in an increase of $72,050. When that number is rounded as required by the FCPIA Act,[9] the inflation-adjusted maximum becomes $1,175,000 or 1 percent of the total assets of the credit union, whichever is less, per day.

2. 12 U.S.C. 1782a(d)(2)

In a provision similar to that discussed above, NCUA is authorized to require each credit union to provide periodic certified statements of the amount of insured shares in the credit union, as well as to pay required deposits into the National Credit Union Share Insurance Fund. The failure to submit a required certified statement or the submission of a false or misleading statement subjects a credit union to three levels or tiers of CMPs, depending upon the reasons for noncompliance.

Calculation of the Adjustment

The CMPs authorized by 12 U.S.C. 1782a(d)(2) were last adjusted by NCUA in 2000. Therefore, these CMPs should be multiplied by 6.55 percent to arrive at the new adjusted amounts (before required rounding).

First Tier CMPs

The maximum CMP authorized by 12 U.S.C. 1782a(d)(2)(A) for an inadvertent failure to timely submit a certified statement or an inadvertent submission of a false or misleading certified statement is $2,000 for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for inflation in 2000, the maximum penalty was increased to $2,200 for each day. Multiplying the current penalty of $2,200 by 6.55 percent results in an increase of $144.10. When that number is rounded as required by the FCPIA Act,[10] the inflation-adjusted maximum remains $2,200.

Second Tier CMPs

The maximum CMP authorized by 12 U.S.C. 1782a(d)(2)(B) for a non-inadvertent failure to timely submit a certified statement, or a non-inadvertent submission of a false or misleading certified statement, or the failure or refusal to pay any required deposit or premium for insurance is $20,000 for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for inflation in 2000, the maximum penalty was increased to $22,000 for each day. Multiplying the current penalty of $22,000 by 6.55 percent results in an increase of $1,441. When that number is rounded as required by the FCPIA Act,[11] the inflation-adjusted maximum remains $22,000.

Third Tier CMPs

The maximum CMP authorized by 12 U.S.C. 1782a(d)(2)(C) for a failure to submit a report or the submission of a false or misleading report done knowingly or with reckless disregard is $1,000,000 or 1 percent of the total assets of the credit union, whichever is less, for each day the failure continues or such false or misleading information is not corrected. After the required adjustment for inflation in 2000, the maximum penalty was increased to $1,100,000 for each day. Multiplying the current penalty of $1,100,000 by 6.55 percent results in an increase of $72,050. When that number is rounded as required by the FCPIA Act,[12] the inflation-adjusted maximum becomes $1,175,000 or 1 percent of the total assets of the credit union, whichever is less, per day.

3. 12 U.S.C. 1785(e)(3)

Pursuant to 12 U.S.C. 1785(e)(1), NCUA is authorized to promulgate regulations to provide minimum standards with which each insured credit union must comply with respect to security devices and procedures to discourage robberies, burglaries and larcenies and to assist in the identification and apprehension of persons who commit such acts. A credit union that violates such a regulation is subject to a CMP for each day the violation continues.

Calculation of the Adjustment

The CMPs authorized by 12 U.S.C. 1785(e)(3) were last adjusted by NCUA in 2000. Therefore, these CMPs should be multiplied by 6.55 percent to arrive at the new adjusted amounts (before required rounding).

The maximum CMP authorized by 12 U.S.C. 1785(e)(3) for non-compliance with NCUA security regulations is $100 for each day the violation continues. After the required adjustment for inflation in 2000, the maximum penalty was increased to $110 for each day. Multiplying the current penalty of $110 by 6.55 percent results in an increase of $7.21. When that number is rounded as required by the FCPIA Act,[13] the inflation-adjusted maximum remains $110.

4. 12 U.S.C. 1786(k)(2)

NCUA is authorized to impose three levels or tiers of CMPs upon insured credit unions or institution-affiliated parties for certain conduct. First and second tier CMPs were not increased for inflation in 2000 because the amount of the increase was not large enough as a result of the rounding rules. Because these CMPs were last adjusted for inflation in 1996, they should now be increased by 17.23 percent to arrive at the new adjusted amounts (before required rounding). Third tier CMPs were increased for inflation in 2000 and therefore, should now be increased by 6.55 percent (before required rounding).

First Tier CMPs

First tier CMPs, 12 U.S.C. 1786(k)(2)(A), may be imposed for the violation of any law or regulation, the violation of certain final orders or temporary orders, the violation of conditions imposed in writing by the NCUA Board, or the violation of any written agreement between the credit union and NCUA. The statute provides that first tier CMPs shall not be more than $5,000 for each day the violation continues. After the required adjustment for inflation in 1996, the maximum penalty was increased to $5,500 for each day. Multiplying the current penalty of $5,500 by 17.23 percent results in an increase of $947.65. When that number is rounded as required by the FCPIA Act,[14] the inflation-adjusted maximum for a first tier CMP becomes $6,500.

[9] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (6) multiple of $25,000 in the case of penalties greater than $200,000.'' Section 5(a), FCPIA Act. Therefore, $72,050 is rounded to the nearest multiple of $75,000 or to $75,000.

[10] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (3) multiple of $1,000 in the case of penalties greater than $1,000 but less than or equal to $10,000.'' Section 5(a), FCPIA Act. Therefore, $144.10 is rounded to the nearest multiple of $1,000 or to $0.

[11] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (4) multiple of $5,000 in the case of penalties greater than $10,000 but less than or equal to $100,000.'' Section 5(a), FCPIA Act. Therefore, $1,441 is rounded to the nearest multiple of $5,000 or to $0.

[12] ''Any increase determined under this subsection shall be rounded to the nearest– * * * (6) multiple of $25,000 in the case of penalties greater than $200,000.'' Section 5(a), FCPIA Act. Therefore, $72,050 is rounded to the nearest multiple of $75,000 or to $75,000.

[13] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (2) multiple of $100 in the case of penalties greater than $100 but less than or equal to $1,000.'' Section 5(a), FCPIA Act. Therefore, $7.21 is rounded to the nearest multiple of $100 or to $0.

[14] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (3) multiple of $1,000 in the case of penalties

Second Tier CMPs

Second tier CMPs, 12 U.S.C. 1786(k)(2)(B), are authorized for violations described in first tier CMPs, the reckless engaging in an unsafe or unsound practice in conducting the affairs of a credit union, or the breach of any fiduciary duty, when the violation, practice or breach is part of a pattern of misconduct, or causes or is likely to cause more than a minimal loss to the credit union, or results in pecuniary gain or other benefit. The statute provides a maximum second tier CMP of $25,000 for each day the violation, practice or breach continues. After the required 1996 adjustment for inflation, the maximum penalty was increased to $27,500 per day. Multiplying the current penalty of $27,500 by 17.23 percent results in an increase of $4,738.25. When that number is rounded as required by the FCPIA Act,[15] the inflation-adjusted maximum for a second tier CMP becomes $32,500.

Third Tier CMPs

Third tier CMPs, 12 U.S.C. 1786(k)(2)(C), may be imposed for any of the acts described in second tier CMPs that cause a substantial loss to the credit union or a substantial pecuniary gain or other benefit. The amount of third tier CMPs depends upon the status of the respondent required to pay the CMP, 12 U.S.C. 1786(k)(2)(D). For a person other than an insured credit union, under the statute, the maximum third tier CMP is $1,000,000 for each day the violation, practice or breach continues. For an insured credit union, the statute provides a daily maximum CMP of the lesser of $1,000,000 or 1 percent of the total assets of the credit union. In 2000, the maximum CMP for a person other than an insured credit union was increased for inflation to $1,175,000 per day. At the same time, the maximum CMP for an insured credit union was increased to the lesser of $1,175,000 or 1 percent of the total assets of the credit union. Multiplying the current penalty of $1,175,000 by 6.55 percent results in an increase of $76,962.50. When that number is rounded as required by the FCPIA Act,[16] the new maximum inflation-adjusted third tier CMP becomes $1,250,000.

5. 42 U.S.C. 4012a(f)

Pursuant to 42 U.S.C. 4012a(f), NCUA is authorized to impose CMPs against a credit union that is found to have a pattern or practice of committing certain specified actions in violation of the National Flood Insurance Program.

Calculation of the Adjustment

The CMPs authorized by 42 U.S.C. 4012a(f) were last adjusted by NCUA in 2000. Therefore, these CMPs should be multiplied by 6.55 percent to arrive at the new adjusted amounts (before required rounding).

The maximum CMP authorized by 42 U.S.C. 4012a(f) is $350 for each violation, up to a maximum of $100,000 per calendar year. After the required adjustments for inflation in 2000, the maximum penalty was increased to $385 for each day, up to a maximum of $110,000 per calendar year. Multiplying the current penalty of $385 by 6.55 percent results in an increase of $25.22. When that number is rounded as required by the FCPIA Act,[17] the inflation-adjusted maximum remains $385. Multiplying the current annual maximum of $110,000 by 6.55 percent results in an increase of $7,205. When that number is rounded as required by the FCPIA Act,[18] the inflation-adjusted annual maximum penalty becomes $120,000 per calendar year.

The NCUA Board now adopts this final rule to adjust the forgoing CMPs for the rate of inflation, as required by the FCPIA Act. As provided in the final rule, the revised CMP amounts will only apply to violations that occur after the effective date of the final rule.

C. Regulatory Procedures

Final Rule Under the Administrative Procedures Act

The FCPIA Act requires adjustments of CMPs for inflation to occur at least every four years. Additionally, the FCPIA Act provides federal agencies with no discretion in the adjustment of CMPs for inflation. Thus, NCUA is unable to vary the amount of the adjustments to reflect any views or suggestions provided by commenters. Further, the regulation is ministerial and technical. For all of these reasons, the NCUA Board finds good cause to determine that public notice and comment for this new regulation is unnecessary, impractical and contrary to the public interest, pursuant to the Administrative Procedure Act (APA), 5 U.S.C. 553(b)(3)(B).

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under ten million dollars in assets). The proposed rule would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the proposed rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the Executive Order. This final rule will apply to all federally-insured credit unions, but it will not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined the final rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

greater than $1,000 but less than or equal to $10,000.'' Section 5(a), FCPIA Act. Therefore, $947.65 is rounded to the nearest multiple of $1,000 or to $1,000.

[15] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (4) multiple of $5,000 in the case of penalties greater than $10,000 but less than or equal to $100,000.'' Section 5(a), FCPIA Act. Therefore, $4,738.25 is rounded to the nearest multiple of $5,000 or to $5,000.

[16] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (6) multiple of $25,000 in the case of penalties greater than $200,000.'' Section 5(a), FCPIA Act. Therefore, $76,962.50 is rounded to the nearest multiple of $25,000 or to $75,000.

[17] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (2) multiple of $100 in the case of penalties greater than $100 but less than or equal to $1,000.'' Section 5(a), FCPIA Act. Therefore, $25.22 is rounded to the nearest multiple of $100 or to $0.

[18] ''Any increase determined under this subsection shall be rounded to the nearest- * * * (5) multiple of $10,000 in the case of penalties greater than $100,000 but less than or equal to $200,000.'' Section 5(a), FCPIA Act. Therefore, $7,205 is rounded to the nearest multiple of $10,000 or to $10,000.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–21) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget has reviewed this rule and has determined that for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, it is not a major rule.

List of Subjects in 12 CFR Part 747

Credit unions, Civil monetary penalties.

By the National Credit Union Administration Board on September 27, 2004.

Mary Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Change in Official or Senior Executive Officer in Credit Unions That Are Newly Chartered or Are in Troubled Condition

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its rule concerning the requirement that federally-insured credit unions that are newly chartered or troubled file notice with NCUA before adding or replacing a board or committee member or employing or changing the duties of a senior executive officer. The amendments clarify the relationship between the prior notice provision and the commencement of service provision, so as to eliminate any potential confusion. In addition, the amendments reorganize the requirements in the current rule to make it easier to understand.

DATES: This rule is effective on November 26, 2004.

FOR FURTHER INFORMATION CONTACT: Ross P. Kendall, Staff Attorney, Division of Operations, Office of General Counsel, at telephone: (703) 518–6562.

SUPPLEMENTARY INFORMATION:

Background

On June 24, 2004, the NCUA Board requested comment on proposed changes to § 701.14 of its regulations, clarifying the procedures that newly chartered or troubled federally-insured credit unions must follow to obtain NCUA approval before adding or replacing board or committee members or changing the duties of a senior executive officer. 69 FR 39871 (July 1, 2004). The proposed amendments clarify the relationship between the prior notice provision and the commencement of service provision in the current rule to eliminate confusion and reorganize the requirements to make the rule easier to understand.

NCUA received comments regarding the proposed changes from two federal credit unions, two national credit union trade associations, one state credit union trade association and one state credit union supervisory association, for a total of six comments.

Summary of Comments

The comments were generally favorable and supportive of the amendments, and all but one commenter supported the efforts to clarify and reorganize the provisions of the rule. Two commenters supported the proposal as published without recommending any changes.

One commenter recommended that the revised rule include a specific reference to the role of the state supervisory authority (SSA) in cases involving state-chartered credit unions. The rule, however, implements authority in the Federal Credit Union Act specifically authorizing the NCUA to review and approve of the service of certain senior credit union officials and employees of federally-insured credit unions, including credit unions that are state-chartered. 12 U.S.C. 1790a. While the NCUA is the decision maker in these cases, the current rule does require a state-chartered, federally-insured credit union to provide a copy of the NCUA notice to its SSA. 12 CFR 701.14(d)(1). In addition, the Board notes that another provision of our regulations also requires NCUA to consult with the appropriate SSA and provide it with notice concerning NCUA's decision. 12 CFR 741.205. The Board has not adopted this recommendation to otherwise reference the role of SSAs.

Another commenter suggested that the rule provide that a request for approval of an official's or employee's service to be deemed complete unless the regional office specifically requires additional information within ten days of its receipt of the request.

The current rule provides that the appropriate NCUA regional office will notify the credit union within ten days of its receipt of the request for approval either that the request is complete or that additional information is required and the Board is not aware of any instances of problems with the current procedure. The final rule retains this provision. The rule already calls for the regional office to advise the credit union about whether the request is complete and providing an automatic determination that an application is deemed complete within ten days could create confusion with the provision in the rule providing for automatic approval if a Regional Director fails to issue a written decision within thirty days. In addition, the suggested revision could, in fact, delay processing. A regional office may determine that it wants to provide an applicant with an opportunity to supplement a submission after performing an initial review. A credit union will generally be willing to provide additional information if it is able since failure to do so would likely result in the disapproval of its request.

One commenter suggested that NCUA exclude service by employees from coverage of the rule. This commenter contends that selection and oversight of employees should be the exclusive province of the board of directors, absent some indication that the board has behaved unethically or is responsible for the credit union's unhealthy financial condition. The authority in the FCU Act for this rule specifically addresses senior executive employees as well as board and committee members. 12 U.S.C. 1790a(a). Senior executives are directly involved in and are responsible for the day-to-day operation of a credit union, and the Board believes their competence is as critical as that of the elected officers and board members. Accordingly, the Board has not adopted this recommended change.

One commenter noted its opposition to the proposal, contending that the current rule permits an officer or senior executive employee to commence service on an interim basis until such time as the credit union is notified in writing of NCUA's determination to disapprove such service. The commenter has mistakenly characterized the current rule, which only permits such interim service if NCUA grants a waiver from the otherwise mandatory thirty-day notice. The proposed amendments preserve the ability of a credit union to seek a waiver from the advance notice requirements in those cases in which the circumstances may warrant service to begin immediately. The final rule clarifies any ambiguity in the current rule between the operation of the prior notice and commencement of service provisions in the rule. The final rule retains the waiver provisions that provide sufficient flexibility where circumstances warrant immediate service yet permits the regional offices to conduct the review contemplated by the Federal Credit Union Act.

Final Rule

In view of the comments, NCUA is adopting the proposed amendments as a final rule without change.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities. NCUA considers credit unions having less than ten million dollars in assets to be small for purposes of RFA. Interpretive Ruling and Policy Statement (IRPS) 87–2 as amended by IRPS 03–2. The amendment clarifies the relationship between the waiver of prior

notice provision and the temporary service provision, so as to eliminate any potential confusion. The NCUA has determined and certifies that this amendment will not have a significant economic impact on a substantial number of small credit unions. Accordingly, the NCUA has determined that a Regulatory Flexibility Analysis is not required.

Paperwork Reduction Act

NCUA has determined that this amendment would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget (OMB). NCUA currently has OMB clearance for § 701.14's collection requirements (OMB No. 3133–0121).

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The amendment will apply to all federally-insured credit unions. NCUA has determined that the amendment will not have a substantial direct effect on the States, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this amendment does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

NCUA has determined that this amendment will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 701

Credit unions, Senior executive officials.

By the National Credit Union Administration Board on October 21, 2004.

Mary Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 723

Member Business Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending the collateral and security requirements of its member business loans (MBL) rule to enable credit unions subject to the rule to participate more fully in Small Business Administration (SBA) guaranteed loan programs.

DATES: This final rule is effective November 26, 2004.

FOR FURTHER INFORMATION CONTACT: Frank Kressman, Staff Attorney, Office of General Counsel, at (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

In 2003, NCUA amended its MBL rule and other rules related to business lending to enhance credit unions' ability to meet their members' business loans needs. 68 FR 56537 (October 1, 2003). In addition to comments on those amendments, NCUA received other suggestions on how it could improve the MBL rule. Among the most significant of these, commenters suggested NCUA amend the MBL rule ''so that it could be better aligned with lending programs offered by the Small Business Administration,'' such as the SBA's Basic 7(a) Loan Program. *Id.* at 56538. While NCUA recognized the merits of this suggestion, NCUA could not include it in the final rulemaking because it addressed issues outside the scope of the rulemaking. The Administrative Procedure Act generally prohibits Federal Government agencies from adopting rules without affording the opportunity for public comment. 5 U.S.C. 553. NCUA noted in the final rule, however, that it would review this suggestion to determine if it would be appropriate to act on it in a subsequent rulemaking.

As a result of that review, NCUA issued a proposed amendment to its MBL rule in June 2004 to permit credit unions to make SBA guaranteed loans under SBA's less restrictive lending requirements instead of under the more restrictive MBL rule's lending requirements. 69 FR 39873 (July 1, 2004). NCUA reviewed the SBA's loan programs in which credit unions can participate and determined they provide reasonable criteria for credit union participation and compliance within the bounds of safety and soundness. Additionally, these SBA programs are ideally suited to the mission of many credit unions to satisfy their members' business loans needs.

NCUA noted in the proposal that it recognizes NCUA's collateral and security requirements for MBLs, including construction and development loans, are generally more restrictive than those of the SBA's guaranteed loan programs and could hamper a credit union's ability to participate fully in SBA loan programs. As a result, the MBL rule's collateral and security requirements could prevent a credit union from making a particular loan that it could otherwise make under SBA's requirements. NCUA issued the proposal to provide relief from these more restrictive requirements and to help enable credit unions to better serve their members' business loans needs.

B. Clarification of Existing Authority

NCUA discussed in the proposal that its Office of General Counsel in Legal Opinion 03–0911, dated May 20, 2004, clarified that NCUA's general lending rule and the Federal Credit Union Act (Act) permit federal credit unions (FCUs) to make MBLs under the terms of the SBA's guaranteed loan programs to the extent the terms and conditions under which the guarantee is provided are consistent with the requirements and limitations in the MBL rule. 12 CFR 701.21(e); 12 U.S.C. 1757(5)(A)(iii). Specifically, the opinion identified loan maturity limits, usury ceilings and prepayment penalties as terms of the SBA's guaranteed loan programs that an FCU could use in lieu of corresponding terms in NCUA's rules. The opinion stated, however, that a credit union could not rely on the exception for government guaranteed loan programs in NCUA's general lending rule and the Act with regard to collateral requirements for MBLs. 12 CFR 701.21(e); 12 U.S.C. 1757(5)(A)(iii). The opinion explained the MBL rule expressly sets collateral requirements for MBLs in the form of maximum loan-to-value ratios. The collateral requirements of the SBA's guaranteed loan programs are not consistent with those of the current MBL rule and, therefore, cannot be used. The proposed amendments to the MBL rule remove that impediment by exempting SBA guaranteed loans from the MBL rule's collateral requirements.

The proposal also noted that there could be circumstances where a business loan made under an SBA loan program would not be subject to the MBL rule. For example, a $40,000 business loan with an SBA guarantee to a member who has no other loans with the originating credit union would be too small to meet the definition of an MBL. Thus, the credit union in this example can rely on the authority provided by § 701.21(e) of NCUA's rules and make a business loan as part of an SBA loan program under all of the terms and conditions required or permitted by the program.

The MBL rule applies to all FCUs and to most federally-insured state credit unions (FISCUs). The proposal noted that a FISCU is exempt from the MBL rule only if, after August 7, 1998, the enactment of the Credit Union Membership Access Act (CUMAA), Public Law 105–21, its state supervisory authority (SSA) has adopted its own business loan rule, with the approval of the NCUA Board, for use instead of NCUA's MBL rule. The amendments regarding collateral requirements apply to all credit unions subject to the MBL rule, but it is important to note that legal opinion OGC 03–0911 applies only to FCUs, not FISCUs. FISCUs follow state law and regulation with respect to loan maturity, interest rate and prepayment penalties. For those issues, the relationship between any state law limitations and SBA's requirements should be determined by FISCUs in consultation with their state supervisory authority.

Finally, the proposal noted that, while NCUA believes many credit unions would greatly benefit from participating in SBA programs, NCUA also believes that programs of this type can create some additional safety and soundness concerns. For example, the loans being guaranteed are often riskier than other loans made by credit unions, and most credit unions would not make these kinds of loans without the security the SBA guarantees provide. NCUA noted it is aware that SBA guarantee programs generally place stringent requirements on participating lenders to comply with program requirements or face losing the guarantee. Accordingly, the proposal recommended that, before a credit union becomes a participating lender, it makes certain it fully understands the terms of the program and has procedures in place to assure its compliance with all program requirements.

C. Summary of Comments

NCUA received twenty-four comment letters regarding the proposed rule: four from FCUs, three from state credit unions, one from a private individual, seven from credit union trade organizations, one from a credit union service organization, one from a certified development company, one from a certified development company

trade organization, one from a professional association representing state and territorial regulatory agencies, one from a bank, and four from banking trade organizations. All commenters supported the proposal except the bank and banking trade organizations.

Many of the commenters supporting the proposal also offered additional comments. For example, seven commenters asked NCUA to clarify that the proposal applies to SBA's Certified Development Company (504) Loan Program in addition to SBA's Basic 7(a) Loan Program. NCUA confirms the proposal applies to the 504 Loan Program and highlights that the proposal expressly states it applies to MBLs made *as part of* an SBA guaranteed loan program.

Four commenters suggested NCUA expand the scope of the proposal to include other government guaranteed loan programs. Three of them specifically named the Farm Service Agency or United States Department of Agriculture loan programs. Two of them suggested all government guaranteed loan programs be included. As noted in the preamble to the proposal, NCUA is willing to consider other government guaranteed loan programs as it becomes apparent there is demand for the program among credit unions.

Two commenters suggested NCUA reference Part 702 Prompt Corrective Action (PCA) in § 723.4 of the MBL rule to indicate PCA applies to member business lending. These commenters also stated it is burdensome for credit unions to have to track and report MBLs differently for different purposes. Specifically, they noted credit unions must do this when calculating net member business loan balances (NMBLB) under the MBL rule and risk-based net worth (RBNW) requirement under PCA. One of these commenters asked NCUA to explore ways of minimizing this burden. The other suggested using the NMBLB for purposes of calculating the RBNW requirement and permit credit unions to exclude MBLs that have been paid down below $50,000 from the calculation of the RBNW requirement. Part 702 is currently referenced in § 723.1 but not in § 723.4. NCUA is including a reference to part 702 in § 723.4 in the final rule. While NCUA recognizes there is some degree of inconvenience associated with tracking and reporting MBLs differently when calculating NMBLB and RBNW, NCUA believes the risks associated with making MBLs necessitate this form of accounting. Additionally, this system helps preserve the flexibility a credit union has to exclude MBLs from its NMBLB when they have been paid down below $50,000.

Three commenters asked NCUA to clarify how an SBA loan term could be both less restrictive than an NCUA requirement and still consistent with the MBL rule. This is possible when an SBA term is less restrictive than an NCUA requirement that is not specifically addressed in the MBL rule. For example, maturity limits are not specifically addressed in the MBL rule but are in the Act and elsewhere in NCUA's regulations.

The bank and four banking trade organizations opposed the proposal stating, among other things, it contradicts congressional intent to limit credit unions' ability to make MBLs. NCUA disagrees. The proposal does not increase any congressional limits on the kind or amount of MBLs a credit union may make. Moreover, the legal authority allowing credit unions to make MBLs under the terms of an SBA guaranteed loan program is in the Act and, therefore, directly reflecting congressional intent. Finally, congressional representatives have urged NCUA to use its authority, conferred by Congress, to facilitate MBL lending and to refrain from imposing any limitations on credit unions in this context not explicitly called for by Congress in CUMAA. 68 FR 56537, 56538 (October 1, 2003).

Accordingly, except for technical amendments, NCUA adopts the proposed amendments to part 723 as final without change.

D. Net Member Business Loan Balance

The MBL rule uses the phrase ''net member business loan balance'' to describe the outstanding loan balance plus any unfunded commitments reduced by a number of factors. Section 723.10(h) uses the phrase ''outstanding member business loan balance'' instead of ''net member business loan balance.'' This inconsistent use of language was inadvertent and is corrected by amending § 723.10(h) to read ''net member business loan balance.''

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions (those under ten million dollars in assets). This rule permits credit unions to more fully participate in SBA loan programs, without imposing any additional regulatory burden. The final rule would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that the final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 723

Credit, Credit unions, Reporting and recordkeeping requirements.

By the National Credit Union Administration Board on October 21, 2004.

Mary F. Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Parts 717 and 748

Fair Credit Reporting—Proper Disposal of Consumer Information Under the Fair and Accurate Credit Transactions Act of 2003

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board is adopting a final rule to implement section 216 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) by amending security program regulations and NCUA's Guidelines for Safeguarding Member Information and establishing a section in new part 717. The final rule generally requires federal credit unions (FCUs) to develop, implement, and maintain appropriate measures to properly dispose of consumer information derived from consumer reports to address the risks associated with identity theft. FCUs are expected to implement these measures consistent with the provisions in NCUA's Guidelines for Safeguarding Member Information.

DATES: Effective December 29, 2004.

FOR FURTHER INFORMATION CONTACT: Chrisanthy J. Loizos, Staff Attorney, Office of General Counsel, National Credit Union Administration, (703) 518–6540.

SUPPLEMENTARY INFORMATION:

I. Introduction

Section 216 of the FACT Act adds a new section 628 to the Fair Credit Reporting Act (FCRA) that, in general, is designed to protect a consumer against the risks associated with unauthorized access to information about the consumer contained in a consumer report, such as fraud and identity theft. 15 U.S.C. 1681w. Section 216 of the FACT Act requires NCUA to adopt a rule requiring any FCU ''that maintains or otherwise possesses consumer information, or any compilation of consumer information, derived from consumer reports for a business purpose to properly dispose of any such information or compilation.'' Pub. L. 108–159, 117 Stat. 1985–86. The FACT Act mandates that the rule be consistent with the requirements issued pursuant to the Gramm-Leach-Bliley Act (GLBA) (Pub. L. 106–102), as well as other provisions of Federal law. The FACT Act also requires NCUA to consult and coordinate with the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), Federal Trade Commission (FTC), and Securities and Exchange Commission (collectively, the Agencies) so that, to the extent possible, NCUA's rule is consistent and comparable with the regulations issued by each of the other agencies.

II. Background

In 2001, NCUA amended the security program rule to establish standards for federally insured credit unions (FICUs) relating to administrative, technical, and physical safeguards to protect the security and confidentiality of member records and information, pursuant to section 501 of GLBA. 15 U.S.C. 6805(b). NCUA worked with the Agencies and state insurance authorities to develop appropriate standards. 66 FR 8152 (Jan. 30, 2001). The Federal banking agencies issued their standards as guidelines under section 39 of the Federal Deposit Insurance Act. 12 U.S.C. 1831p.[1] NCUA determined it could best meet the congressional directive to prescribe standards by amending the rule governing security programs and by providing guidance in an appendix to the rule. 12 CFR part 748, appendix A; 66 FR 8152 (Jan. 30, 2001).

Section 748.0 requires an FICU to develop a security program that implements safeguards designed to: (1) Ensure the security and confidentiality of member records and information; (2) protect against any anticipated threats or hazards to the security or integrity of such records; and (3) protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to a member. 12 CFR 748.0(b)(2).

Appendix A to part 748 sets forth NCUA's Guidelines for Safeguarding Member Information (Guidelines), which are substantially identical to the guidelines issued by the Agencies. 66 FR 8152 (Jan. 30, 2001). The Guidelines ''are intended to outline industry best practices and assist credit unions to develop meaningful and effective security programs to ensure their compliance with the safeguards contained in the regulation.'' *Id.*

The Guidelines direct FICUs to assess the risks to their member information and member information systems and, in turn, implement appropriate security measures to control those risks. 12 CFR part 748, appendix A. For example, under the risk-assessment framework, FICUs should evaluate whether the controls the FICU has developed sufficiently protect its member information from unauthorized access, misuse, or alteration when the FICU disposes of the information. ''[A] credit union's responsibility to safeguard member information continues through the disposal process.'' 66 FR 8152, 8155.

On May 28, 2004, the NCUA Board published a proposal to add a section to the new fair credit reporting rule and amend the security program rule and Guidelines for Safeguarding Member Information (Guidelines) to require FCUs to implement controls designed to ensure the proper disposal of consumer information within the meaning of section 216. 69 FR 30601 (May 28, 2004). NCUA's proposed regulation and the preamble were substantively similar to a joint notice of proposed rulemaking issued by the FRB, OCC, FDIC and OTS (the Federal banking agencies). 69 FR 31913 (June 8, 2004).

In the proposal, NCUA noted that section 216 of the FACT Act requires NCUA to issue final regulations for entities under its enforcement authority under section 621 of the FCRA. Unlike the current provisions in the security program rule, which apply to all FICUs, the requirements in NCUA's final rule apply solely to FCUs. *See* 15 U.S.C. 1681s(b)(3). Federally insured state-chartered credit unions are subject to the enforcement jurisdiction of the FTC for purposes of the FCRA. *See* 15 U.S.C. 1681s(a). State charters, therefore, should refer to the final rule issued by the FTC regarding the proper disposal of consumer information under section 216.

III. Summary of Comments

NCUA received fourteen comment letters: One from a corporate credit union; four from natural person credit unions; five from credit union trades or leagues; one from a consumer; two from financial services trade organizations; and a joint letter from seven consumer rights organizations. The Agencies also received numerous letters from financial institutions, industry trade organizations, consumer advocacy groups, consumers, and trade associations from the information destruction industry. NCUA and the Agencies considered the comments and suggestions submitted.

Of the letters received by NCUA, twelve commenters generally supported the proposed regulation requiring FCUs to properly dispose of consumer information. One commenter stated that the proposal balanced the concerns of consumers and the industry by providing reasonable protections from identity theft and the unintended

[1] 12 CFR parts 30, app. B; 208, app. D–2 and 225, app. F; 364, app. B; 570, app. B. *See* 66 FR 8616 Feb. 1, 2001.

disclosure of consumer information while giving FCUs sufficient latitude for the disposal of consumer information. One comment letter, submitted on behalf of seven consumer groups, found the proposed rule weak and inadequate to meet Congress' intended purpose of preventing identity theft and other fraud.

IV. Analysis of Final Rule

Section-by-Section Overview

Section 717.83—Disposal of Consumer Information

As set forth in the proposal, NCUA is establishing a new part 717 to house its fair credit reporting rules and adds a subpart setting forth the duties of users of consumer reports regarding identity theft. To implement section 216, NCUA is adding § 717.83 to require FCUs to develop and maintain, as part of their information security programs, appropriate controls designed to ensure that they properly dispose of consumer information. The final rule retains the statute's rule of construction as proposed stating that this requirement does not impose any requirements to maintain or destroy consumer records beyond those imposed by any other law. The final rule also does not affect any requirement to maintain or destroy consumer records imposed under any other provision of law.

The only revisions to § 717.83 from the proposed rule incorporate examples of appropriate measures to properly dispose of consumer information and clarify ''consumer information'' in its definition and through examples. These additions required a renumbering of the section and are discussed in further detail below.

The final rule also includes a general definitions section, § 717.3, to define the terms ''you'' and ''consumer.'' Although these definitions were not included in the proposed disposal rule, they were published in another FACT Act proposal.[2] The final rule refers to FCUs using the plain language term ''you'' because section 216 requires NCUA to adopt a final disposal rule for FCUs. The final rule also uses the term ''consumer.'' Paragraph (e) of § 717.3 defines the term ''consumer'' to mean an individual, which follows the statutory definition in section 603(c) of the FCRA. 15 U.S.C. 1681a(c). NCUA will add more definitions to § 717.3 as the agency adopts other rules to implement provisions of the FCRA.

Section 748.0—Security Program

The final rule retains § 748.0(c) as proposed. Paragraph (c) cross references the section 216 requirement in § 717.83, for ease of reference when FCUs adopt or modify their information security programs.

Guidelines for Safeguarding Member Information

The final rule amends the Guidelines to specifically address the disposal of consumer information by: (1) Defining ''consumer information'' as defined in § 717.83; (2) adding an objective regarding the proper disposal of member information and consumer information; and (3) providing that an FCU should implement appropriate measures to properly dispose of member information and consumer information. NCUA discusses the final rule's slight variations from the proposal below.

The changes to the Guidelines are intended to provide guidance to FCUs for compliance with § 717.83. As noted above, the requirements of this final rule only apply to FCUs, while federally insured state-chartered credit unions are subject to the jurisdiction of the FTC on this matter. NCUA believes, however, that federally insured state charters may find this guidance helpful in adopting meaningful and effective security programs that deal with the disposal of consumer information.

In accordance with section 216, NCUA has consulted with the Agencies to ensure that, to the extent possible, the final rules issued by the respective agencies to implement section 216 are consistent and comparable.

Proper Disposal of Consumer Information and Member Information

Consumer Information

Proposed § 717.83(c)(1) defined ''consumer information'' to mean ''any record about an individual, whether in paper, electronic, or other form, that is a consumer report or is derived from a consumer report and that is maintained or otherwise possessed by or on behalf of the credit union for a business purpose.'' ''Consumer information'' was also defined to mean ''a compilation of such records.''

Commenters generally supported NCUA's proposed definition of this term, but argued that NCUA should include statements or illustrations to clarify the nature and scope of ''consumer information.'' Several commenters found the proposed phrase ''about an individual'' to be ambiguous and urged NCUA to adopt a definition expressly stating that ''consumer information'' only includes information that identifies a particular individual.

Similarly, some commenters supported NCUA's explanation in the proposal that ''consumer information'' does not include information derived from a consumer report that does not identify any particular consumer, such as the mean credit score derived from a group of consumer reports. These commenters suggested that NCUA include this example or similar examples in the definition.

In § 717.83(d)(1), the final rule defines ''consumer information'' as proposed but modifies the term to expressly exclude from the definition ''any record that does not identify an individual.'' NCUA believes that qualifying the term ''consumer information'' to cover only personally identifiable information appropriately focuses on the information derived from a consumer report that, if improperly disposed, could be used to commit fraud or identity theft against a consumer. NCUA believes that limiting this definition to information that identifies a consumer is consistent with the current law relating to the scope of the term ''consumer report'' under the FCRA and the purposes of section 216 of the FACT Act.

Under the final rule, an FCU must implement measures to properly dispose of consumer information that identifies a consumer, such as the consumer's name and the credit score derived from a consumer report. This requirement, however, does not apply to aggregate information, such as the mean credit score that is derived from a group of consumer reports, or blind data, such as a series of credit scores that do not identify the subjects of consumer reports from which those scores are derived. The final rule includes examples of records that illustrate this aspect, but it does not rigidly define the nature and scope of personally identifiable information. These examples are found in § 717.83(d)(1)(i). NCUA notes that there are a variety of types of information apart from an individual's name, account number, or address that, depending on the circumstances or when used in combination, could identify the individual.

As discussed in the proposal, NCUA notes that the scope of information covered by the terms ''consumer information'' and ''member information'' will sometimes overlap, but will not always coincide. The definition of ''consumer information'' is drawn from the term ''consumer'' in

[2] On April 8, 2004, NCUA issued its first proposal to add a new part 717, implementing section 411 of the FACT Act. *See* 69 FR 23380 (Apr. 28, 2004). This final disposal rule, however, will be the first section to establish the new part 717.

section 603(c) of the FCRA, which defines a ''consumer'' as an individual. 15 U.S.C. 1681a(c). By contrast, ''member information'' under the Guidelines, only covers nonpublic personal information about a ''member,'' as defined in § 716.3(n), namely, an individual who obtains a financial product or service to be used primarily for personal, family, or household purposes and who has a continuing relationship with the FCU.

The relationship between consumer information and member information can be illustrated through the following examples. Payment history information from a consumer report about an individual, who is an FCU's member, will be *both* consumer information because it comes from a consumer report and member information because it is nonpublic personal information about a member. In some circumstances, member information will be broader than consumer information. For instance, information that an FCU maintains about its member's transactions with the FCU would be only member information because it does not come from a consumer report. In other circumstances, consumer information will be broader than member information. Consumer information would include information from a consumer report that an FCU obtains about an individual who guarantees a loan for a business entity or who has applied for employment with the FCU. In these instances, the consumer reports would not be member information because the information would not be about a ''member'' within the meaning of the Guidelines but would be consumer information.

NCUA believes the phrase ''derived from consumer reports'' covers all of the information about a consumer that is taken from a consumer report, including information that results in whole or in part from manipulation of information from a consumer report or information from a consumer report that has been combined with other types of information. Consequently, an FCU that possesses any of this information must properly dispose of it. For example, any record about a consumer derived from a consumer report, such as the consumer's name and credit score, that is shared between an FCU and its credit union service organization (CUSO) affiliate must be disposed of properly by each affiliate that possesses that information. Similarly, a consumer report that is shared among affiliates after the consumer has been given a notice and has elected not to opt out of that sharing, and therefore is no longer a ''consumer report'' under section 603(d)(2)(A)(iii) of the FCRA, would still be consumer information. Accordingly, an affiliate that receives consumer information under these circumstances must properly dispose of the information. NCUA notes that a CUSO affiliate subject to the jurisdiction of the FTC must properly dispose of consumer information in accordance with the FTC's final rule.

The proposed definition of consumer information included the qualification ''for a business purpose,'' as set forth in section 216. NCUA believes that this phrase encompasses any commercial purpose for which an FCU might maintain or possess consumer information. Commenters did not raise concerns about this interpretation.

Proper Disposal

In the proposed rule, NCUA requested comment on the standard for proper disposal. Of the comment letters received by NCUA, five commenters thought that the concept was clear and sufficiently explained the nature and scope of an FCU's responsibilities under the rule, but two of those commenters welcomed additional clarification through guidance or examples. Four commenters believed ''proper disposal'' was not clear in the proposed rule and asked for either a definition or examples in the regulatory text like those used in the FTC's proposed rule. 69 FR 21388 (April 20, 2004). Some of these commenters stated that the rule should adopt a clear standard that requires FCUs to render paper and electronic data unreadable and incapable of being reconstructed. They also asked that the rule provide examples of proper disposal techniques consistent with the FTC's proposed regulatory text.

NCUA believes that there is no need to adopt a definition of the term ''disposal'' because, in the context of the duty imposed under section 216, the ordinary meaning of that term applies. The final rule, however, includes examples of appropriate measures to properly dispose of consumer information as requested by the commenters in renumbered paragraph (b) of § 717.83. NCUA believes these examples will be helpful as illustrative guidance for compliance with the rule.

NCUA notes that any sale, lease, or other transfer of any medium containing consumer information constitutes disposal of the information insofar as the information itself is not the subject of the sale, lease or other transfer between the parties. By contrast, the sale, lease, or other transfer of consumer information from an FCU to another party can be distinguished from the act of throwing out or getting rid of consumer information, and accordingly, does not constitute disposal subject to NCUA's rule.

New Objective for an Information Security Program

NCUA proposed to add a new objective regarding the proper disposal of consumer information in paragraph II.B. of the Guidelines. A few commenters expressed objections to this aspect of the proposal primarily as it relates to service providers.

The final rule slightly revises the proposal to add a new objective in the Guidelines providing that an FCU should design its information security program to ''[e]nsure the proper disposal of member information and consumer information.'' With this revision from the proposal, NCUA omitted the proposed provision stating that an FCU should ensure proper disposal of consumer information ''in a manner consistent with the disposal of member information.'' By making this change and adding the reference to ''member information'' in paragraph II.B., the Guidelines more clearly and fully state an FCU's information security objectives with respect to disposing of information. As noted in the proposal, a credit union should properly dispose of member information as part of designing and maintaining its information security program under the Guidelines. The inclusion of ''member information'' in the objective, therefore, does not establish a new objective in the Guidelines.

NCUA continues to believe that including this additional objective in paragraph II.B. of the Guidelines is important because section 216's disposal requirement applies to an FCU's consumer information maintained or otherwise in the possession of the FCU's service providers. NCUA notes that, under current paragraph III.D.2., an FCU is expected to ''[r]equire its service providers by contract to implement appropriate measures designed to meet the objectives'' of the Guidelines.

By expressly incorporating a provision in paragraph II.B. of the Guidelines, FCUs should contractually require service providers to develop appropriate measures for the proper disposal of consumer information and, where warranted, monitor service providers to confirm that they have satisfied their contractual obligations. As some commenters observed, the particular contractual arrangement that an FCU may negotiate with a service provider may take varied forms or use general terms. As a result, some credit unions already may have existing

contracts that are sufficiently broad to cover the proper disposal of member information and consumer information, and therefore they would not have to be amended. NCUA continues to believe that the parties should have substantial latitude in negotiating the contractual terms appropriate to their arrangement in any manner that satisfies the objectives of the Guidelines. NCUA, therefore, has not prescribed any particular standards that relate to these service provider contracts.

The final rule also amends paragraph III.G.4. of the Guidelines to allow an FCU a reasonable period of time, after the final rule is issued, to amend its contracts with its service providers to incorporate the necessary requirements in connection with the proper disposal of consumer information. After reviewing the varying comments on this provision of the proposal, NCUA has determined that FCUs should modify contracts that will be affected by the final rule's requirements, if necessary, no later than July 1, 2006.

New Provision To Implement Measures to Properly Dispose of Consumer Information

NCUA has amended paragraph III.C. of the Guidelines by adding a new provision stating that an FCU, as part of its information security program, should develop, implement, and maintain, appropriate measures to properly dispose of consumer information and member information. Like the proposal, this new provision also provides that FCUs should implement these measures ''in accordance with the provisions in paragraph III.'' of the Guidelines.

Paragraph III. of the Guidelines presently states that an FCU should undertake measures to design, implement, and maintain its information security program to protect member information and member information systems. Because ''member information systems'' is defined to include any methods used to dispose of member information, an FCU presently must use risk-based measures to protect member information. Building on this provision in the Guidelines, NCUA proposed a provision in paragraph III.C.4. stating that FCUs should develop controls ''in a manner consistent with the disposal of member information.'' Commenters generally supported this provision because FCUs could develop and implement risk-based protections, rather than be subject to a prescriptive standard that required them to adopt particular methods for disposing of consumer information.

In the final rule, NCUA has revised the proposed provision in paragraph III.C.4. by omitting ''in a manner consistent with the disposal of member information.'' In its place, the Guidelines now provide a more direct and general statement that FCUs should develop and maintain risk-based measures to properly dispose of consumer information and member information. Under this final amendment to the Guidelines, an FCU is expected to properly dispose of both classes of information, which is consistent with the Guidelines and the FACT Act.

An FCU should broaden the scope of its risk assessment to include an assessment of the reasonably foreseeable internal and external threats associated with the methods it uses to dispose of consumer information, and adjust its risk assessment in light of the relevant changes relating to such threats. By expressly referencing the disposal requirement in § 748.0(c) and the Guidelines, NCUA expects FCUs to integrate into their information security programs the risk-based measures in paragraph III of the Guidelines for the disposal of consumer information.

After reviewing the comments, NCUA continues to believe that it is not necessary to propose a prescriptive rule describing proper methods of disposal.

Nonetheless, consistent with interagency guidance previously issued through the Federal Financial Institutions Examination Council (FFIEC),[3] NCUA expects FCUs to have appropriate disposal procedures for records maintained in paper-based or electronic form. In addition, as noted above, the final rule includes illustrative examples of appropriate measures to properly dispose of consumer information in § 717.83(b). An FCU's information security program should ensure that paper records containing either member or consumer information should be rendered unreadable as indicated by the FCU's risk assessment, such as by shredding or any other means. FCUs also should recognize that computer-based records present unique disposal problems. Residual data frequently remains on media after erasure. Since that data can be recovered, FCUs should apply additional disposal techniques to sensitive electronic data.[4]

Compliance

The final rule requires FCUs to implement the appropriate measures to properly dispose of consumer information by July 1, 2005. NCUA believes that any changes to an FCU's existing information security program likely will be minimal because many of the measures that an FCU already uses to dispose of member information can be adapted to properly dispose of consumer information. Several commenters agreed with NCUA's assessment and noted that they already have appropriate disposal policies in place. Nevertheless, a comment on behalf of small credit unions and a few comments to the Federal banking agencies noted the proposed period for compliance would be relatively short in light of the work required to amend policies and locate and track consumer information in an institution's existing information system. Accordingly, NCUA has determined that the final rule should afford FCUs a six-month period to adjust their systems and controls.

V. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact any proposed regulation may have on a substantial number of small entities (those under $10 million in assets). The NCUA Board has determined and certifies that the final rule will not have a significant economic impact on a substantial number of small credit unions. Accordingly, a regulatory flexibility analysis is not required.

The rule requires an FCU to implement appropriate controls designed to ensure the proper disposal of consumer information. An FCU must develop and maintain these controls as part of implementing its existing information security program as required by § 748.0.

Any modifications to an FCU's information security program needed to address the proper disposal of consumer information could be incorporated through the process the FCU presently uses to adjust its program under paragraph III.E. of the Guidelines, particularly because of the similarities between the consumer and member information and the measures commonly used to properly dispose of both types of information. To the extent the rule imposes new requirements for certain types of consumer information, developing appropriate measures to properly dispose of that information likely would require only a minor modification of an FCU's existing information security program.

Because some consumer information will be member information and

[3] *See* FFIEC Information Security Booklet, page 63 at: *http://www.ffiec.gov/ffiecinfobase/booklets/information—security/information—security.pdf.*

[4] *See* footnote 3, *supra.*

because segregating particular records for special treatment may entail considerable costs, NCUA believes that many FCUs, including small entities, already are likely to have implemented measures to properly dispose of both member and consumer information. In addition, NCUA and the Federal banking agencies, through the Federal Financial Institutions Examination Council (FFIEC), already have issued guidance regarding their expectations concerning the proper disposal of *all* of an institution's paper and electronic records. *See* FFIEC Information Security Booklet, December 2002, p. 63.[5] Therefore, the rule does not require any significant changes for FCUs that currently have procedures and systems designed to comply with this guidance.

NCUA anticipates that, in light of current practices relating to the disposal of information in accordance with § 748.0, the Guidelines, and the guidance issued by the FFIEC, the final rule would not impose undue costs on FCUs. NCUA believes that the controls that small FCUs would need to develop and implement, if any, to comply with the rule likely pose a minimal economic impact on those entities.

[5] *See* footnote 3, *supra.*

Paperwork Reduction Act

NCUA has determined that the final rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on State and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule will not have substantial direct effects on the States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that the final rule does not constitute a policy that has federalism implications for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedures Act. 5 U.S.C. 551. The Office of Management and Budget (OMB) has determined that this rule is not a major rule for the purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

The Treasury and General Government Appropriations Act, 1999—-Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

List of Subjects

12 CFR Part 717

Consumer protection, Credit unions, Information, Privacy, Reporting and recordkeeping requirements.

12 CFR Part 748

Credit unions, Crime, Currency, Reporting and recordkeeping requirements, and Security measures.

By the National Credit Union Administration Board on November 18, 2004.

Mary F. Rupp,

Secretary of the Board.